FUNDAÇÃO GETULIO VARGAS

ESCOLA DE ADMINISTRAÇÃO DE EMPRESAS DE SÃO PAULO

FABIAN OPPENHEIMER

IMPACT INVESTING:

PORTFOLIO COMPANY SELECTION IN LATIN AMERICA

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Thesis presented to Escola de Administração de Empresas de São Paulo of Fundação Getulio Vargas, as a requirement to obtain the title of Master in International Management (MPGI).

Knowledge Field: IMPACT INVESING

Advisor: PhD Renato Orsato

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ABSTRACT

The paper analyses how Impact Investors select their portfolio companies in Latin America and what criteria are assessed in the process. Since virtually no research on this has been conducted to date, and since the selection process model applied in Venture Capital is not dissimilar, that approach has been adopted. The findings reveal that Impact Investors originate and assess deals in a similar way to Venture Capitalists, but that some criteria are adjusted and others added in order to reflect the dual objective of Impact Investing. Impact Investors can originate deals passively, but they prefer searching for social ventures proactively: personal contacts, access to networks and industry events are crucial in this context. Impact Investors considering an investment in Latin America search for integer, honest and reliable social entrepreneurs committed to social impact; eligible social ventures must be profitable with potential for further scalability; the product must have a social impact, i.e. create value for the individual consumer and for the wider community; market size and market growth are crucial external factors; and the deal features depend on the investor's risk attitude and the prospects of a successful exit in both financial and social terms. Impact Investors are also willing to provide non-financial support prior to an investment, if a social venture shows high potential for achieving their dual objective.

KEY WORDS: Impact Investing, Selection Process, Assessment Criteria

RESUMO

O documento analisa como investidores de impacto selecionar suas companhias de portfólio na América Latina e que critérios são avaliados no processo. Uma vez que praticamente nenhuma pesquisa sobre isso foi con conduzidos até à data, e desde que o modelo de processo de seleção aplicados em capital de risco não é dissemelhantes, foi adotado essa abordagem. Os resultados revelam que os investidores de impacto originar e avaliar negócios de uma forma semelhante a capitalistas de risco , mas que alguns critérios são ajustados e outros adicionados a fim de refletir o duplo objectivo de investimento de impacto. Os investidores de impacto podem originar ofertas passivamente, mas eles preferem procurar empreendimentos sociais de forma proativa: contatos pessoais, o acesso a redes e eventos do setor são cruciais neste contexto. Impacto Investidores considerando um investimento em pesquisa para a América Latina inteira, empreendedores sociais honestos e confiáveis comprometidos com impacto social; empreendimentos sociais elegíveis devem ser rentáveis com potencial de escalabilidade; o produto deve ter um impacto social, ou seja, criar valor para o consumidor individual e para a comunidade em geral; tamanho do mercado e crescimento do mercado são fatores externos cruciais; e as características de negócio dependem de atitude de risco do investidor e as perspectivas de uma saída bem sucedida, tanto em termos financeiros e sociais. Os investidores de impacto também estão dispostos a dar apoio não financeiro antes de um investimento, se um empreendimento social, mostra alto potencial para atingir o seu objectivo dual.

KEY WORDS: Impact Investing, Selection Process, Assessment Criteria

Table of Content

1 Introduction 10

2 Literature Review 13

2.1 Social Entrepreneurship 13

2.2 Venture Capital 17

2.3 Philanthropy 20

2.4 Impact Investing 25

2.4.1 Definition 26

2.4.2 Differentiation 29

2.4.3 Approaches 30

2.5 Selection Process Model 32

2.5.1 Deal Origination 34

2.5.2 Deal Screening and Evaluation 35

3 Methodology 38

3.1 Mixed Methods Exploratory Sequential Design 38

3.2 Data 41

4 Empirical Findings 43

4.1 Deal Origination 43

4.1.1 Passive Deal Origination 43

4.1.1.1 Networking 44

4.1.1.2 Internet 46

4.1.1.3 Miscellaneous 47

4.1.1.4 Other 48

4.1.1.5 Interim Findings 49

4.1.2 Proactive Deal Origination 50

4.1.2.1 Networking 50

4.1.2.2 Miscellaneous 52

4.1.2.3 Interim Findings 54

4.2 Deal Screening and Evaluation 54
4.2.1 Deal Screening 55
4.2.1.1 Criteria 55
4.2.1.2 Interim Findings 57
4.2.2 Deal Evaluation 58
4.2.2.1 Requested Documents 59
4.2.2.2 Entrepreneur and Management Team 65
4.2.2.3 Social Venture 68
4.2.2.4 Product 73
4.2.2.5 External Factors 76
4.2.2.6 Deal Features 79
4.2.2.7 Interim Findings 83
4.3 Declined Proposals 84
5 Impact Investing is Venture Capital with a Philanthropic Twist 86
6 Limitations and Further Research 90
6.1 Limitations 90
6.2 Further Research 91
7 Conclusion 93
References 95
Appendix 105

List of Figures

Figure 1: Strategic attributes of Philanthropy and Venture Capital in Impact Investing 28

Figure 2: Investment Strategies 29

Figure 3: Segments of Impact Investing 31

Figure 4: Selection Process Model in Venture Capital 33

Figure 5: Basic Exploratory Sequential Design 39

Figure 6: Detailed Exploratory Sequential Design 39

Figure 7: Exploratory Sequential Design – Instrument Development Model 40

Figure 8: Passive Deal Origination in Impact Investing 44

Figure 9: Proactive Deal Origination in Impact Investing 50

Figure 10: Dimensions for deal evaluation in Impact Investing 59

List of Tables

Table 1: Deal origination in Venture Capital 34

Table 2: Screening criteria in Venture Capital 35

Table 3: Evaluation criteria in Venture Capital 36

Table 4: Passive deal origination in Impact Investing 45

Table 5: Proactive deal origination in Impat Investing 51

Table 6: Screening criteria in Impact Investing 56

Table 7: Required documents for proposal evaluation in Impact Investing 60

Table 8: Evaluation criteria - Entrepreneur and Management Team 67

Table 9: Evaluation criteria - Social Venture 69

Table 10: Evaluation criteria - Product 74

Table 11: Evaluation criteria - External Factors 77

Table 12: Evaluation criteria - Deal Features 80

Table 13: Declined proposals 85

1 Introduction

The global financial crisis that began in 2008 led to a reconsideration and shift in the predominant mindset of traditional finance. Investors started to question the strict focus on financial returns. The awareness grew that the time for new and more holistic types of investment had come: non-financial objectives are becoming more important. Terms such as “social business” (Yunus, 2007) and “Social Responsible Investing” are noticed by and discussed in the general public[1]. Simultaneously, actors engaged in Philanthropy became increasingly dissatisfied with what had been achieved by their grants and donations, encouraging them to professionalise their investment approach and to adopt better established procedures (Letts, Ryan & Grossmann, 1997). This two-fold development gave rise to a new term: Impact Investing, i.e. a new attitude towards investment, which sought to generate financial returns and profit, while simultaneously achieving value for society and the environment[2]. Investors realised that social impact and financial returns do not necessarily preclude, but can embrace each other (Jaquier, 2011). Hence, Impact Investing developed as a new financing form for social entrepreneurship.

Before investigating the phenomenon of Impact Investing or specific aspects of it, the scope of the concept has to be considered. Increasing attention on the term itself has led to the misleading idea that any investment strategy with a social orientation can be regarded as Impact Investing. However, the approach goes beyond e.g. negative screening, which focuses on avoiding allocating capital to harmful investments or to corporate programmes mainly aimed at enhancing image. Instead, Impact Investing actively places capital in social ventures[3] that provide innovative, scalable and sustainable solutions to prevailing problems, but still remains performance-based. Letts, Ryan and Grossmann (1997) were the first to propose applying Venture Capital’s approaches, methods and procedures to the financing of social enterprises.

Maximization in Venture Capital focuses on financial return and shareholder value (Kleinschmidt, 2007, p. 17). , while in Philanthropy it centres on value for society (Wagner, 2002, p. 349). Impact Investing combines both targets and strives to optimise the balance between social impact and financial return (Jaquier, 2011, p. 20); in this approach, eligible ventures therefore have to be identified that are able to fulfil the dual objective. To date, the selection

[1] cf. Hoepner (2007) for a literature overview on SRI.
[2] In the following, the term *social impact* is used to refer to both social and / or environmental impact.
[3] In the following, the term *social venture* is used to refer to any organisational form of social entrepreneurship (cf. Section 2.1).

process – which is rigorous in view of the prevailing constraints – has not been investigated in depth, although practitioners and academics are already showing an increasing interest in Impact Investing. Thus there are no detailed insights on how deals are originated in Impact Investing, or on which criteria are assessed during the selection process.

The foremost objective of this paper is therefore to investigate the selection process in Impact Investing, by identifying the sources used for deal origination and by exploring both the process and the criteria applied in deal selection. The paper thus aims to answer the following research questions:

In Impact Investing, how are portfolio companies selected in Latin America?
What criteria are applied in the region for screening and evaluating proposed investments?

As already indicated, no in-depth research has been conducted to date on the topic of Impact Investing. Strategically speaking, the two concepts of Impact Investing and Venture Capital are relatively close to each other: given their similarity in terms of approach, methods and procedures, aspects of deal origination and selection in Impact Investing are compared to those featured in Venture Capital. This paper therefore uses the selection process model established in Venture Capital as a basis for exploring the sources of proposals put forward in Impact Investing, and for investigating the evaluation and selection criteria subsequently applied for assessment purposes.

The study by Scarlata and Alemany (2009) is reflected here as regards the basic procedure and methodology, but there are two vital differences between their study and this paper. While Scarlata and Alemany focus on Venture Philanthropy and funds engaging in the U.S. and Europe, this paper specifically focuses on Impact Investing and funds engaging in social ventures in Latin America.

This paper focuses on Latin America, since this region is highly attractive for Impact Investing, due to its emerging markets, up-coming economies and increasing wealth. At the same time, a large portion of the population still does not benefit from recent positive developments. Hence, an increasing number of Impact Investing funds see opportunities to finance social ventures that evolve from within the respective communities, featuring scalable business models and offering innovative products or services to create social value.

The paper applies the *Exploratory Sequential Design* to identify deal origination and the selection criteria applied in Impact Investing on the Latin American market. First, interviews with eight selected Impact Investing funds were conducted, to identify the sources and crite-

ria. Second, an online questionnaire was developed and distributed amongst identified Impact Investing funds active in Latin America. The contacts were obtained from the two databases *ImpactAssets50* and *ImpactBase*, as well as from networking, recommendations and Internet research. Since only 13 responses were registered, the results obtained lacked statistical validity; the statistical analysis originally intended thus had to be substituted by combining the findings of the personal interviews and the online questionnaire, which were then used as a basis for a qualitative interpretation. The findings of the study must thus be regarded as tendencies and indications rather than as generally valid results.

This paper proceeds as follows. Section 2 outlines Venture Capital and Philanthropy, because selected strategic elements of these theoretical concepts are incorporated in Impact Investing; all three approaches offer investment possibilities for social entrepreneurship. Section 3 describes the methodology applied in order to answer the research questions. Section 4 presents and interprets the empirical findings obtained from the study. On the basis of the empirical findings, Section 5 summarizes the findings of the study and suggests propositions regarding the selection process and assessment criteria. Section 6 outlines the limitations of the research conducted and indicates areas for further research. The conclusion follows in Section 7.

2 Literature Review

2.1 Social Entrepreneurship

Social entrepreneurship (SE) as a concept developed within the discipline of commercial entrepreneurship. Both in academia and in practice, a consistent definition clearly outlining what qualifies as SE does not exist (Christie & Honig, 2006, p. 1; Mair & Martí, 2006, p. 37; Weerawardena & Mort, 2006, p. 21; Short, Moss & Lumpkin, 2009; p. 161), although the topic has experienced increasing attention within the academic world (Dacin, Dacin & Tracey, 2011, p. 1203) and become an important economic phenomenon of great relevance (Dacin, Dacin & Matear, 2010, p. 37) on a global scale (Mair & Martí, 206, p. 36; Zahra, Rawhouser, Bhawe, Neubaum & Hayton, 2008, p. 117). Actually defining SE is therefore one of the most crucial questions in any discussion of the subject, and a great number of various definitions has emerged (Dacin et. al., 2010, p. 39ff.). Almost every academic paper on the topic begins by contemplating which definition might be trendsetting: Peattie and Morley (2008) even describe the situation as a *"definitional minefield"* (p. 95).

The lack of a generally acknowledged definition may be explained by the fact that the development of a corresponding theory is likewise lacking (Haugh, 2012, p. 10; Nicholls, 2010, p. 611; Santos, 2012; p. 336). Paettie and Morley (2008) point out that social entrepreneurs' characteristics are considered to describe the whole phenomenon of SE: "*The definitional problems (...) stem from a tendency amongst authors to describe* [social entrepreneurship] *in terms of particular characteristics, without attempting to differentiate between those that typify* [social entrepreneurship] *and those that define* [social entrepreneurs]" (p. 95). The various definitions of SE therefore tend to focus for one thing on the characteristics of individual social entrepreneurs, highlighting specific qualities, behaviours, motivations, leadership skills, the ability to recognize opportunities and to acquire required resources (Light, 2009, p. 22; Tan, Williams & Tan, 2005, p. 359).

The term SE is also used to refer to business activities and market-based skills being applied to the development of innovative actions that solve social challenges (Mair & Martí, 2006. p. 37). Austin, Stevenson and Wei-Skillern (2006) define SE as "*entrepreneurial activity with an embedded social purpose*" (p.1). Seelos and Mair (2005) outline that SE involves the creation of innovative business models that effectively address basic human needs (p. 241) – innovation is seen as a key aspect of SE (Casson, 2005, p. 344). Zahra et. al. (2008) highlight that the innovative solutions that originate from SE and target problems within a local context, gain global relevance due to replication and adaptation in other regional settings (p. 128).

Hence, SE in general is deemed to create new industries, validate new business models and re-direct resources to neglected societal problems (Santos, 2012, p. 335). SE identifies and exploits market opportunities that result in social value: the aspect of social value is a main characteristic of SE consistently mentioned in various definitions (Peredo & McLean, 2006, p. 59; Shaw & Carter, 2007, p. 425ff.) Brooks (2009) also states that "*SE generally works with – not against – market forces"* (p. 3).

Two different schools of thought – the "*Earned Income School of Thought*" and the "*Social Innovation School of Thought*" (Dees & Anderson, 2006, pp. 41ff.) – further complicate the understanding of SE. The first of these two doctrines focuses on the generation of earned income in the pursuit of social outcomes (Boschee, 2001, p. 15) and describes the economically motivated combination of income generation and social objectives; thus organisations apply market-based solutions to social problems, achieve social objectives directly or by reinvesting profits in social projects, and thus create both economic and social value. In contrast, the second doctrine refers to innovative business activities actually aimed at achieving social change: based on the concept of Schumpeter (1934), innovatively combined economic resources revolutionize the production process and create value specifically in order to address social problems; here, SE therefore refers more to the social impact achieved and less to the income generated.

Both schools of thought consider blurred frontiers to some extent, balancing and integrating economic and social purposes and strategies – a challenge characterising SE, leading to ongoing tensions (Tracey & Philips, 2007, p. 267). Especially within the *Earned Income School of Thought,* a distinction is made between the *commercial non-profit approach,* focussing on non-profit organisations that integrate commercial methods in order to support their social purpose, and the *mission-driven business approach,* embracing all organisations that aim to achieve social objectives, including for-profit companies. Academic discussion within this school of thought stresses the *double bottom line* and the creation of *blended value,* which combines economic and social intentions. The ongoing debate is closing the gap towards the *Innovation School of Thought,* which in turn accepts blurred frontiers and explicitly considers the existence of opportunities for entrepreneurial social innovation within the private for-profit sector (Defourny & Nyssens, 2010, pp. 40ff.). SE however is assumed to encompass dual objectives, namely social objectives that aim to create value for the community, and financial objectives that ensure the continuance and sustainability of the organisation.

The social problem addressed is regarded as the main driver of SE in both schools of thought. Organisations choose the most appropriate legal form for achieving the targeted social impact; SE is not therefore defined by legal status – it may be chosen arbitrarily. Moreover, legal status does not necessarily determine the SE model, which may be incorporated as either a non-profit or for-profit organisation (Scarlata & Alemany, 2008, p. 4): both non-profit and for-profit organisations are assumed capable of generating both economic and social value. The choice of model mainly depends on external factors, such as regulation, the prevailing legal system, capitalisation and access to capital, as well as on management and ownership decisions.

Based on the "*Social Innovation School of Thought*", there is an ongoing discussion amongst academics: there are including and excluding definitions, which differ as regards the specification, objective and characteristics of SE. Light (2006) gives an including definition: *"A social entrepreneur is an individual, group, network, organisation, or alliance of organisations that seeks sustainable, large-scale change through pattern-breaking ideas in what or how governments, non-profits, and business do to address significant social problems"* (p. 50).

In this context, Dacin et. al. (2011) mention *"significant challenges relating to definitional and conceptual clarity"* (p. 1203). Martin and Osberg (2007) criticize that such including definitions do not contribute to the clarification of SE: the term is *" (...) so inclusive that it now has an immense tent into which all manner of socially beneficial activities fit"* (p. 30). Under a broad inclusive definition – such as that offered by Austin et. al. (2006): *"social entrepreneurship* [is an] *innovative, social value-creating activity that can occur within or across the non-profit, business, or government sectors"* (p. 2) – SE is likely to be found everywhere. Martin and Osberg therefore offer a broadly recognized excluding definition: *"The social entrepreneur should be understood as someone who targets an unfortunate but stable equilibrium that causes the neglect, marginalisation, or suffering of a segment of humanity; who brings to bear on this situation his or her inspiration, direct action, creativity, courage, and fortitude; and who aims for and ultimately affects the establishment of a new stable equilibrium that secures permanent benefit for the targeted group and society at large"* (p. 39). This defines social entrepreneurs as entrepreneurs with a social mission, combining the two concepts of entrepreneurship and social mission. In this sense, entrepreneurs use their business skills and knowledge, to achieve social impact while being commercially viable (Mair & Martí, 2006, p. 39).

Haugh (2007) similarly defines SE as the *"simultaneous pursuit of economic, social, and environmental goals by enterprising ventures"* (p. 743). Zahra, Gedajlovic, Neubaum and Shulman (2009) provide an analogous definition: *"Social entrepreneurship encompasses the activities and processes undertaken to discover, define, and exploit opportunities in order to enhance social wealth by creating new ventures or managing existing organisations in an innovative manner"* (p. 522).

However, discussion about SE often acquires an idealistic touch, as the definition of Dees (2001) indicates: "*Social entrepreneurs play the role of change agents in the social sector, by: adopting a mission to create and sustain social value (not just private value), recognising and relentlessly pursuing new opportunities to serve that mission, engaging in a process of continuous innovation, adaptation, and learning, acting boldly without being limited by resources currently in hand, and exhibiting heightened accountability to the constituencies served and for the outcomes created"* (p. 4).

Having summarized different assumptions and characteristics used for defining SE in existing literature, Light (2008) concluded that the findings hitherto are not maintainable (pp. 22ff.). That author argues that an appropriate definition needs to reflect the fundamental objective of SE, namely addressing social problems and improving social conditions (pp. 11ff.).

Santos (2012) has presented a different theoretical approach: he regards SE from the perspective of an independent economic theory, and not as a combination of the economic and social sectors. According to his approach, SE addresses social issues that result from government or market failure. He links his approach to the concept of generating and capturing value: commercial enterprises only operate in a specific sector or area provided the generation of value is possible and if the firm may also capture this value. He continues by saying that SE can only occur and develop where commercial enterprises are unable to acquire this potentially generated value.

In particular, the aspects of sustainability and empowerment have to be emphasized. First, SE aims to largely solve the root of the problem or to install a system that continuously addresses the problem – at best, the problem is eliminated permanently. Second, SE empowers the beneficiaries to become part of the sustainable solution: the stakeholders' dependency is reduced, while their ability to contribute to the solution and their own well-being is increased (Santos, 2012, p. 345ff.).

On the basis of the above range of definitions, this study uses the following understanding of the term "social entrepreneurship": SE identifies and exploits market opportunities that are based on social needs; for the social issues identified, SE implements market-driven mechanisms to offer innovative solutions; these solutions must be sustainable and capable of generating a financial profit as well as improving social conditions; SE empowers the community addressed to contribute to its own well-being and thus regards its beneficiaries as additional stakeholders. It is with these features that social ventures – i.e. organisations launched by social entrepreneurs striving for the *double bottom line* of social and economic objectives – attract the attention and interest of Impact Investing funds.

Within academic literature, there are two sub-classifications of social ventures: *Social Business* and *Social Impact Business.* According to Strauch, Schröer and Schmitz (2012), a *Social Business* combines resources and develops sustainable business models, in order to generate social value and to become independent from a single source of financing, such as donations. Profits are re-invested into the business (p. 206). A *Social Impact Business* also strives for social impact – stakeholders however receive a certain return on their investment (Brettel, Grichnik, Koropp & Mauer, 2010, p. 410f.), such as a dividend. Both forms of social ventures strive for the objective of operating independently from a financial perspective, while simultaneously generating social value[4].

For the following investigation, a differentiation is not considered relevant, because the focus lies on the umbrella term *social venture* as an organisational form of SE and the selection criteria that Impact Investors[5] apply for their investment decision.

This paper does not consider entrepreneurial activities that primarily aim at maximizing profits, whilst possibly achieving social objectives at the same time (Choi, Gray & Carroll, 2008). In such cases, social issues are regarded as incidental, providing solutions does not influence or motivate the business activities, and the social value proposition is subordinated.

2.2 Venture Capital

Venture Capital (VC) is the first pillar from which Impact Investing has evolved.

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[4] For further literature on "social business" refer to Yunus (2007)

[5] In the following, the term *Impact Investors* may refer either to individual persons or to institutionalised groups providing capital to social ventures in accordance with the concept of Impact Investing (cf. Section 2.4)

VC is a financing form for entrepreneurship, generally providing capital to small and young firms that encounter difficulties in attracting financing, are characterized by high uncertainty regarding the success of their business, and where information asymmetries between entrepreneurs and investors prevail (Gompers & Lerner, 2001, p. 145).

Academic literature to date offers varying definitions of what qualifies as VC – and different regions in the world have dissimilar understandings (Kraft, 2001, pp. 31f.; Bader, 1996, pp. 4f.). In Europe the term VC refers to the financing of a young company, as opposed to *Private Equity*, which relates to the financing of a buy-out of an already established company. In the USA on the other hand, the two terms are used synonymously for both forms of financing (Diller, 2007, p. 12). The two perspectives are only similar in two regards: only private companies are financed; and the investment is limited and aims to realise a financial return. Generally, VC includes non-financial support for a company besides funding, in order to reduce the investment risk and foster the company's development (Kleinschmidt, 2007, pp. 17f.). *"Venture capital firms typically (...) adopt a 'hands on' investment style in order to limit risk and add value to their investments, requiring close contact to be maintained with investee companies"* (Mason & Harrison, 1999, p. 33).

Adopting the European perspective, VC may be defined as equity or equity-related funding for young and growing companies. Wright and Robbie (1998) define VC *"as the investment by professional investors of long-term, unquoted, risk-equity finance in new firms where the primary reward is an eventual capital gain, supplemented by dividend yield"* (p. 521). *"VC are professionals who pool funds from high net-worth investors and invests these funds into promising young business enterprises"* (Narayansamy, Hashemoghli, & Rashid, 2012, p. 49 based on Jain, 1999). Barry (1994) states that "*venture capital entails the investment of risk capital within a firm in substantial blocks, coupled with the close monitoring of that investment* (p. 4). Kleinschmidt (2007) defines *"Venture capital* [as] *an equity or equity-related financing form for private growth companies for a limited time, including non-financial support for the company"* (p. 17). And Gompers and Lerner (1998) define Venture Capitalists as *"active investors monitoring the progress of firms, sitting on boards of directors, and meting out financing based on the attainment of milestones.* [Retained] *(...) control rights allow them to intervene in the company's operations when necessary"* (p. 151). Moreover, Venture Capitalists take an active role in advising firms and provide access to their business network.

Based on this European perspective and the definitions given above, VC in the following refers to the investment of equity or equivalents in young enterprises that harbour substantial

risks but have big growth potential, whereby this approach also features the provision of continued support after the actual investment. The main aim of VC is to attain an appreciable financial return.

One crucial factor to be remembered here is the additional non-financial but generally remunerated support, which the VC company offers to the enterprise in which the capital is invested. *"Venture capitalists are actively involved in the management of the ventures they fund (...)"* (Sahlman, 1990, p. 473). *"VCs possess specialised knowledge, a deep understanding of a particular industry, and a specialised network of contacts that they share with their affiliate companies"* (according to Gompers & Lerner (1999), in Large & Muegge, 2008, p. 21). *"Classic venture capitalists work as coaches and partners with entrepreneurs and innovators at a very early stage to help shape and accelerate the development of a company"* (Timmons (1999) cited in Moore and Wüstenhagen, 2004, p. 242). In order to contribute effective non-financial support, VC companies have to be specialised in identifying, assessing and monitoring firms which present an investment possibility in any given sector and at any stage of development.

According to Kleinschmidt (2007), VC incorporates four characteristics:

First, investments with VC include equity or equity-related financing; investors obtain information and get control rights; mezzanine instruments similar to equity, such as convertible debt or dormant participation, may be preferred to reduce the associated risk (Kaplan & Strömberg, 2003, p. 286). Moreover, *"there is no pay-back or interest liability for the portfolio company, reducing its risk of insolvency"* (Böhner, 2007, p. 10).

Second, VC is a medium-term investment: VC is provided for a limited investment horizon, the ultimate aim being an exit that produces a substantial financial return. Investors sell shares after two to ten years – depending on the development of the portfolio company (Bader, 1996, p. 14).

Third, VC focuses on growth companies. Only companies with corresponding growth potential are able to fulfil the high return expectations of VC firms (Kleinschmidt, 2007, p. 18). The market entry of the company and subsequent market expansion constitute the potential of young companies (Schefczyk, 2000, p. 18). Large amounts of capital and support are required – but the associated risk limits traditional financing possibilities (Ruppen, 2001, pp. 27f.). Non-financial support by the VC firm compensates for this shortcoming.

Finally, VCs are active investors. VC investors also provide non-financial support to growth companies, not only to reduce the investment risk: the element of risk still remains for investors, as start-up entrepreneurs cannot bear the entire risk (Shane & Cable, 2002, p. 367). According to Kleinschmidt (2007, p. 19), risk is harboured in a three-fold conflict of interests: between the investor and the company's management; between inside and outside investors; and as a result of aiming for strong fast growth (Ruppen, 2001, pp. 28f.). To minimize risk, investors use various contractual agreements to exert greater control over the portfolio company.

As is shown below, Impact Investing incorporates several of the four above-mentioned elements of VC. Otherwise, a further in-depth review of the concept of VC and accompanying literature is waived in this study.

2.3 Philanthropy

Philanthropy is regarded as the second of two pillars from which Impact Investing has evolved.

Philanthropy is a broadly discussed topic – extensive information is available on this interdisciplinary subject, and research appears in journals of almost every academic discipline. Although the term is widely used and often subject to re-definition depending on the context, Philanthropy basically refers to fostering the wellbeing of humankind with charitable aid or donations. The Oxford Dictionary (2013) defines Philanthropy as *"the desire to promote the welfare of others, expressed especially by the generous donation of money to good causes";* this is reflected by authors such as Harrow and Jung (2011), who define Philanthropy as *"use of private funds for public benefit and social change"* (p.1048).

The word *Philanthropy* itself however, is regarded with antipathy and aversion in some countries, *"conjuring up images of a patronising attitude and largesse"* (John, 2006, p. 9). Philanthropy defines social status and emphasizes social distinctions. The donation or giving of money is always based on a certain intention and motivation, be it to shape and influence the future of society positively – but Philanthropy is also directly connected to power, as a relationship between the donor and the receiver is established, providing both parties with certain advantages (Adam, 2004, p. 4). Definitions of Philanthropy therefore often neglect negative associations: *"*[Philanthropy is the] *provision of finance to an organisation for predominantly social benefit"* (John, 2006, p. 9).

The main aspect characterising Philanthropy is the motivation for donating and giving money – in line with the Latin origin of the term *"love of mankind"*. The return of the principal or even the generation of an additional financial return is only a secondary criterion of Philanthropy; any profits generated may either be distributed among the Philanthropists[6] or reinvested into the enterprise. The ultimate objective of Philanthropy however is to advance society in social, cultural or educational terms, by providing resources for the funding of services that the government or the private sector do not offer for political or economic reasons (Adam, 2004, p. 4). For the giving of money to organisations, the concept does not limit itself to specific financial instruments, as long as these instruments primarily enable the creation of value for society and not merely profit for the person donating. Thus grants, returnable grants, loans and equity are all eligible for Philanthropy (John, 2006, p. 9).

According to Emerson (2003), Philanthropy centres on creating social welfare and finding solutions for prevailing social problems that are based on governmental or market failure. The idea of primarily generating financial return is neglected, because the focus on social issues calls for a financial trade-off – high social-target returns are achieved in turn for abolishing a predefined financial floor. Emerson outlines several attributes of Philanthropy (p. 38). Firstly, the objective is to maximize social return. Secondly, the funds used are not generally regarded as a financial investment in a conventional sense, including repayment and financial return. Thirdly, Philanthropy may engage in Program Related Investments, or investments to support charitable activities, which may return capital within a fixed timeframe – including funding methods commonly associated with banks or other private investors. Fourthly, the social impact is measured and assessed. Finally, Philanthropy frequently invests endowments in traditional capital institutions.

Philanthropy has received increasing public attention within the last decade, mainly because of a neo-liberal agenda aimed at reducing the size and influence of government agencies, and the inability of the private sector to provide adequate solutions to pressing social issues; celebrities and HNWI have also founded organisations aiming at publicly effectively supporting the generation of social value (Eikenberry & Nickel, 2009, pp. 974f.). The perception has developed that due to the amount of money available, Philanthropy is capable of solving collective problems in human society. Mounting inequality in terms of global income distribution has further fuelled the call to depend more on Philanthropy to solve the prevailing problems of social welfare, create social capital, and ultimately make society more human

[6] In the following, the term *Philanthropist* may refer either to individual persons or to institutionalised groups providing capital in accordance with the concept of Philanthropy.

(Brooks, 2006; McLean, 2006; Putnam, 2000). Thus Philanthropy is regarded as an additional sector besides the market and the state.

The motivation of why people and organisations make philanthropic donations has been researched extensively in academic literature. Seifert, Morris and Bartkus (2003) provide a broad overview on the motivation of corporate Philanthropy (p. 196). As Saiia, Carroll and Buchholtz (2003) outline, *"corporate giving programs are being run in a manner that benefits the community as well as helping to better position the firm"* (p. 186). In his survey, Marx (1999) also outlines the importance that *"contributions benefit relations with the community and the general public"* (p. 196). Corporate Philanthropy is therefore motivated by economic motives, demonstrating the company's social responsibility towards the community and influencing stakeholders' perception of the firm. In their literature review on Philanthropy, Bekkers and Wiepking (2011) in turn identify the following eight mechanisms that motivate people to donate money: awareness of need; solicitation; costs and benefits; altruism; reputation; psychological benefits; values; efficacy.

Referring to Wagner (2002, p. 349), the concept of Philanthropy may be summarized as follows: organisations or entrepreneurs seeking financial resources to realise their ideas approach Philanthropists that in turn want to contribute to the solution of an identified need. Philanthropists provide partial funding to mainly short-term projects that create models solving identified social issues. The donor has the function of providing private resources for realising a solution that contributes to the public good and generates social value for the community. This is the ultimate objective of Philanthropy; financial returns are merely a secondary condition. The philanthropic process is therefore effectively a re-distribution of financial resources. Philanthropists are motivated depending on their perception of need and their capacity to donate. In Philanthropy, only limited interaction takes place between the donor and the receiving party; collaboration, accountability and responsibility are limited. Consequently, the risk for the funder is also limited – the money donated is not expected to be re-paid or to generate any financial return.

Since it contributes towards solving numerous big societal challenges and conflicts, the concept of social entrepreneurship is becoming increasingly important. According to Dart (2004), social entrepreneurship *"offers innovative solutions to social problems"* (p. 417), but for tackling the ongoing challenges and further increasing the effect of SE activities, *"greater expertise and growth in funds are required"* (Scarlata & Alemany, 2008, p. 6). Nonetheless, Philanthropists have come to realise in practice that the mere provision of charity and dona-

tion of capital fail to achieve the objectives of improving the response to the challenges identified and creating social welfare to the extent envisaged. Indeed, van Slyke and Newman (2006) point out that Philanthropists providing funds face various challenges in supporting social entrepreneurship.

First, as Wagner (2002) mentions, Philanthropy provides partial funding to short-term projects, *"seldom for more than one year"* (p. 348). Thus Philanthropy does not aim to finance entire organisations and merely focuses on supporting particular projects *"which address a specific problem"* (Scarlata & Alemany, 2008, p. 6). Philanthropists often direct funds to *"specific purposes, where they can more easily see results"* (Larson, 2002, p. 81). This indicates that social enterprises' requirements and organisational abilities are secondary. Moreover, *"directed gifts do not give the organisation the flexibility to use funds where the need is greatest"* (p. 81). These facts reduce social entrepreneurs' ability to develop sustainable solutions to the identified social challenges; they "*may even end up lacking the organisational strength* [they] *need to continue* [their] *work"* (Letts, Ryan and Grossman, 1997, p. 4).

Second, by providing donations and grants to specific projects, Philanthropists may misallocate their funds. Since the social entrepreneur receiving the money does not have the flexibility to distribute the donated capital according to actual requirements, some projects are likely to be undercapitalised. *"(...) funders, by restricting funding to programmatic growth, may unintentionally contribute to systemic undercapitalisation"* (Morino & Shore, 2004, p. 17). As a result of such undercapitalisation, social entrepreneurs are forced to continuously search for funding instead of focusing on their social mission (Scarlata & Alemany, 2008, p. 7). This means that many recipients of philanthropic capital face long-term funding uncertainty. As Wood and Martin (2006) state, foundations that "*move with the investment fad of the moment"*, coupled with personal preferences and relationships (p. 1), amplify this tendency. In addition, as Scarlata & Alemany (2008) mention, an employee's compensation is rarely linked to performance, so there is no incentive to increase personal effort. Since employees often experience negative consequences in the event of failure, risk-averse behaviour results (p. 7). This in turn encourages Philanthropists to place smaller amounts of capital, in order to reduce the downside risk – again exposing organisations to undercapitalisation.

Third, Philanthropists do not regard performance measurement as one of their major tasks (Porter & Kramer, 1999, p. 122), often due to *"limited information, personal interest and emotion"* (Wood & Martin, 2006, p. 1). But without reviewing performance, Philanthropists cannot learn whether their donations achieve the desired objectives. Thus the focus on subjec-

tive needs can aggravate the misallocation of funds – in order to enhance the impact of the capital they provide, Philanthropists need to allocate funds on a performance basis. Moreover, if outstanding performance is not measured and subsequently rewarded, social entrepreneurs will have no incentive to utilise the funds provided to maximum effect and to achieve the best possible results: "*excellent performance (...) is rarely systematically rewarded with an increased flow of philanthropic capital. In fact, an opposite situation prevails. As programs were proven effective and the* [social] *organisations developed plans to grow,* [philanthropists] *(...) were less receptive to their requests for funding*" (Grossmann, 1999, p. 3).

Finally, Philanthropists – besides giving donations and grants – do not provide sufficient non-financial support, especially in management terms. It should be realised in this context that social enterprises prefer to be managed by the founder rather than by experienced managers, as Brammer, Millington & Pavelin (2006) outline in their study. Philanthropists therefore have hardly any influence on the management and miss the opportunity to provide further advice.

Realising that their approach failed to achieve the desired results, Philanthropists recognized that the concept of donating money *"would benefit by adopting disciplines used by venture capitalists to ensure that grants are well spent – not just spent"* (Edelson, 2004, p. 1). Grants and donations therefore started being treated as investments, rather than as outright gifts. *"(...) A new consensus is emerging that Philanthropy could be the most important source of working capital for* [social entrepreneurship] – *if (...) restrictive grant funds could function more like capital"* (Ryan, 2001, p. 16). If this revised concept is to be sustainable in the long-term, a more market-driven approach – such as that applied by Venture Capitalists – needs to be applied to entrepreneurial aspects, so as to enable funding to achieve the best possible social impact (Scarlata & Alemany, 2009, p.1). *"It includes taking a performance*-centred, re-*sults orientation"* (Pepin, 2005, p. 167). Philanthropy has thus been combined with market-driven mechanisms from the VC approach.

Letts et. al. (1997) were the first widely mentioned authors to argue that Philanthropists should apply various techniques from the discipline of VC: "[Philanthropists] *need to find new ways to make grants that not only fund programs but also build up the organisational capabilities that* [social entrepreneurs] *need for delivering and sustaining quality. (...)* [Philanthropists] *and venture capitalists face similar challenges: selecting the most worthy recipients of funding, relying on young organisations to implement ideas, and being accountable to the third party whose funds they are investing"* (p. 3). While VC focuses solely on

financial return, Philanthropy applies similar methods for selecting social entrepreneurs in order to achieve predefined social returns.

According to Porter and Kramer (1999), Philanthropists are recommended to adapt and apply three value-creating steps from Venture Capital. First, charities should screen investment opportunities, in order to identify the best social entrepreneurs and their projects: Philanthropists have to *"use their expertise to channel resources to their most productive uses within the social sector"* (p. 123). Second, by building up experience in screening and evaluating social entrepreneurs, as well as by signalling the additional value created, foundations are able to attract and advise their peers: *"(...) it effectively improves the return on a larger pool of philanthropic resources"* (p. 123). Third, foundations are able to create further value by not only providing capital, but also by becoming a fully engaged partner that provides support in enhancing organisational efficiency.

The aforementioned findings indicate that Philanthropists benefit from the Venture Capital approach of screening potential investments, developing investment strategies, and sustaining social enterprises in their long-term needs: "[Philanthropy] *is a financial transaction. Being a responsible grant-maker requires a multidimensional decision-making effort"* (Comstock, 2003, p. 37). Against this background and based on the interpretation of the concept discussed above, this paper adopts the understanding of Philanthropy as structured funding of social ventures, using donations and grants from the private sector and aiming primarily to contribute towards the creation of social value, whereby a financial return is not a prerequisite and is regarded as merely secondary.

2.4 Impact Investing

Impact Investing developed from the aforementioned fields of Venture Capital and Philanthropy, combining various aspects of these two investment approaches. Attempts at a definition already existed in academic literature, but confusion and argument regarding the definition still prevail; what really qualifies as Impact Investing is a matter of lively debate. Definitions to date are deliberately kept broad, reflecting manifold interests and perspectives, and it is evident that a clear understanding of Impact Investing still needs to be established within academia and in practice. Since the financial crisis moreover, the concept of Impact Investing has also – adding to the confusion – developed a reputation of being a respective and socially acceptable form of investment, setting a trend that is attracting a growing amount of hype.

This paper builds upon the latest understanding of Impact Investing as found in literature.

2.4.1 Definition

Impact Investing is generally defined as *"Investing with the specific objective of achieving positive social impact as well as financial return"* (Jaquier, 2011, p. 20). Financial returns in this context follow the traditional understanding that investors accrue capital gains on their investment, while positive social impact refers to the generation of value for society and the well-being of individuals: peoples' lives are affected in some positive way. In order to arrive at a more comprehensive definition, the key elements of the concept have to be considered:

Most important, Impact Investing expects and requires a financial return, or at least repayment of the capital originally invested. Moreover, the capital is provided to businesses or ventures which accord with the prevailing understanding of social entrepreneurship (cf. Section 2.1), and which seek to generate a positive and measurable social impact through market-driven mechanisms. The social impact is a major element of the investment strategy. In addition, the enterprises and ventures are based on a scalable business model, ensure future growth and provide a sustainable solution to an existing social issue. Last but not least, Impact Investors place their capital actively and mostly privately. (GIIN, 2011; J.P.Morgan, 2010; Freireich & Fulton, 2009; Radjy & Cejnar, 2010)

For a sound understanding of Impact Investing, the following aspects also have to be taken into account in order to classify and differentiate the concept (cf. J.P. Morgan, 2010, p. 7; EVPA, 2010):

First, Impact Investing is a long-term investment approach, not focusing on single short-term projects, but on engagements with social ventures lasting several years. The contemplated investment horizon is estimated at up to seven years – in practice however, Impact Investing often calls for further development and the investment cycle may take up to twelve years, depending on the given circumstances.

Second, Impact Investing is characterized by a close relationship between the investor and the social venture, in which management competences, control and support are shared between the two parties. Due to the high engagement and active participation, Impact Investors focus on a small but highly selective portfolio that may consist of not more than twenty companies, depending on factors such as the fund's resources or the social ventures' field of activity.

Third, the relationship in Impact Investing is marked by a high degree of non-financial support: investors aim to increase the organisational capacity of their portfolio companies in or-

der to ensure social impact. This support may include a wide range of unremunerated services and access to the Impact Investor's network.

Fourth, Impact Investing deploys capital through numerous forms of private debt and equity investments, such as Cash and Cash Alternatives; Senior and Mezzanine Debt; Hybrid Capital; Public Equity; Private Equity and Venture Capital; Real Estate and Other Real Assets. Impact Investing therefore combines diverse sources of capital and various financial instruments, depending on the investor's specific portfolio targets and balancing return expectations, risk appetite and impact goals (Jaquier, 2011, pp. 25f.). Impact Investing is thus much broader than conventional private equity investments.

Fifth, Impact Investing is performance-based. To ensure the success of an impact investment in terms of social impact and financial returns, investors focus on management skills, expect sound business planning, demand that milestones be met, and evaluate the results obtained. The positive social effect achieved by Impact Investing is an element fundamental to the investment strategy itself: Impact Investing seeks to achieve a social impact that is both measurable and measured, in order to determine the success of the investment. The financial return of an Impact Investment that is generated may vary, but some financial return is definitely expected and required. The possible scope ranges from return of the principal to full commercial financial returns, from the market rate to above-the-market returns.

Finally, an exit is crucial to Impact Investing. Already during the selection phase, investors evaluate a venture's potential for a successful exit and choose the financial instruments accordingly. Exits in Impact Investing aim to uphold sustainability in social and financial terms: ideally on exit, the venture disposes over adequate financial resources and the social impact generated can be maintained – despite the exit of an investor.

In view of the aforementioned aspects, Impact Investment excludes donations, Philanthropy capital, or certain forms of Venture Philanthropy, where the return of the principal is not necessarily required or expected. Moreover, Impact Investing does not include other investment strategies, such as Socially Responsible Investments (SRI), which merely seek to reduce a negative impact. Thus approaches such as Negative Screening, which exclude sectors or companies involved in certain activities merely on the basis of specific criteria, are insufficient and cannot be defined as Impact Investing.

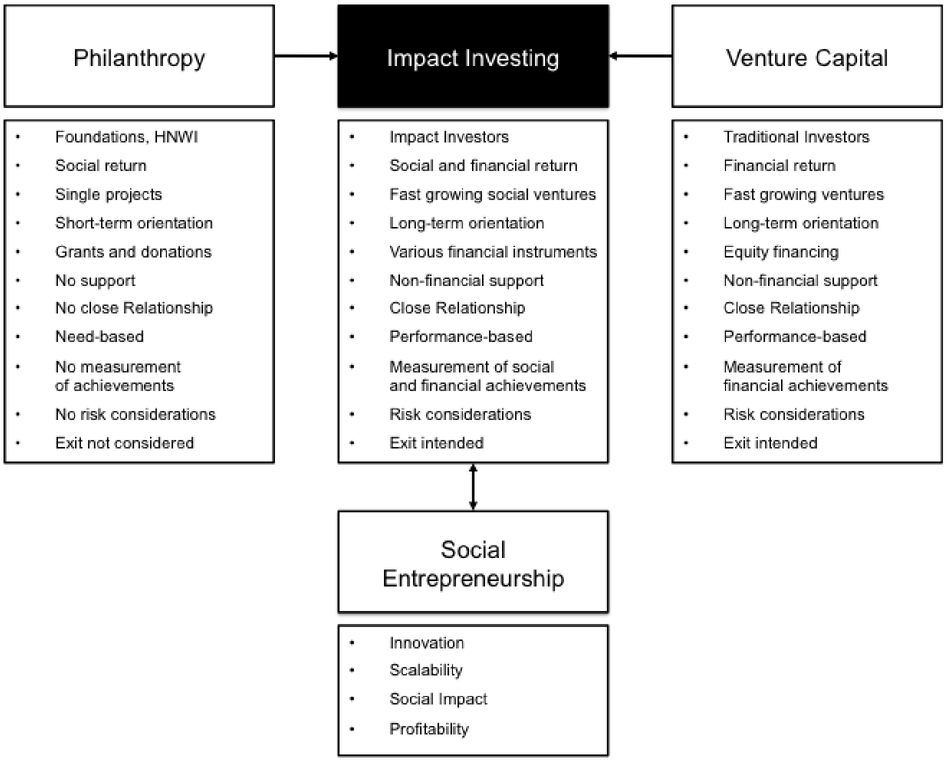

Figure 1: Strategic attributes of Philanthropy and Venture Capital selectively incorporated in Impact Investing

Source: Author's illustration

In the light of the above, the following working definition of Impact Investing is used in this study:

Impact Investing provides mostly private capital for funding social ventures which are in keeping with the aforementioned understanding of social entrepreneurship. These ventures are based on innovative and scalable business models, and they empower the customer by providing sustainable products / services that help to alleviate social problems and improve conditions in the community and / or the environment. An Impact Investment is expected to have a positive and measurable social impact, but it is also required to generate a financial return, at a minimum recouping the capital invested.

As a new form of financing for social entrepreneurship, Impact Investing combines various elements from both Philanthropy and Venture Capital. Generally speaking, Impact Investing has adopted the social objectives from Philanthropy, while the approaches, methods and procedures applied originate from Venture Capital. On the basis of the arguments and findings presented hitherto, Figure 1 shows Impact Investing in relation to the connected fields of Philanthropy, Venture Capital and Social Entrepreneurship.

2.4.2 Differentiation

Impact Investing provides capital to ventures aiming to achieve a positive social impact. However, the term is often erroneously used for different although related approaches, thus creating confusion as to what actually qualifies as Impact Investing. Especially in practice, Impact Investing is related to other terms that in fact have different meanings, such as Venture Philanthropy or SRI. A clear understanding of how to categorize and differentiate Impact Investing is therefore of utmost importance.

There are several aspects distinguishing it from other investment strategies and concepts (Jaquier, 2011, p. 21). Figure 2 illustrates how Impact Investing differs from other investment strategies.

Although Impact Investing has some philanthropic aspects, it differs from charity in that it expects and requires a financial return. Moreover, capital is provided only to social ventures engaged in some commercial activity aiming to generate social impact.

Impact Investing (Thematic – Impact First)

Traditional	Responsible	Sustainable	Thematic	Impact First	Philanthropy
Finance Only ←					→ **Impact Only**
Limited or no focus on social factors of underlying investments	Focus on risks ranging from a wide consideration of social factors to negative screening of harmful products	Focus on social opportunities, through investment selection, portfolio management, shareholder advocacy	Focus on one or a cluster of issues where social needs create commercial growth opportunities for market rate or market-beating returns	Focus on one or a cluster of issues where social needs require some financial trade-off	Focus on one or a cluster of issues where social needs require a complete financial trade-off

Charity (Philanthropy)

Mainstream Investing (Traditional) | Socially Responsible Investing (SRI) (Responsible – Sustainable) | Venture Philanthropy (Impact First – Philanthropy)

Figure 2: Investment Strategies

Source: Author’s illustration based on Bridges Ventures (2012) and Eurosif (2012)

Impact Investing and Venture Philanthropy overlap in terms of the impact that is actively pursued. However, while Venture Philanthropy welcomes but does not require some financial return, the return of an Impact Investment ranges from the return of the principal to full commercial financial returns. Venture Philanthropy moreover differs from Impact Investing, in that it covers the funding of non-profit organisations and charities via grants and donations; Impact Investing does not.

Although Impact Investing and Socially Responsible Investments (SRI) overlap as regards their focus on commercially viable and socially driven enterprises, Impact Investing differs

from SRI in that it actively aims to achieve a positive impact, while SRI often merely seeks to reduce a negative one (Freireich and Fulton, 2009). Moreover, while Impact Investing includes various asset classes, SRI mainly focuses on listed equities. SRI furthermore accepts below-market returns, and it differs from Impact Investing because the target group covers a broader range of social businesses.

2.4.3 Approaches

According to the Freireich and Fulton (2009) there are two different approaches within the given definition of Impact Investing: the *Impact First Approach* and the *Finance First Approach*. However, there are various combined approaches between these two extremes, so called *Mixed Structures*.

Impact Investors implementing an *Impact First Approach "seek to optimise social or environmental impact with a floor for financial returns"* (p. 31). Hence, they prioritize the social impact, although there is still a pre-defined floor for financial returns. This approach emphasizes the investors' mission and motivation to solve current social issues, and it increases the chances for effectively generating social impact. Investors focusing on the social impact either accept a return lower than the achievable market rate, or take higher risks in order to maximize the positive effects of their investment. These investors have the necessary awareness and conscience for tackling a specific social issue. However, the pre-defined financial return is expected to be achieved by the social entrepreneur and is already taken into account when projects are selected. Nonetheless, flexibility on this count is required, as it may range from the return of the principal to above the market return.

Inversely, the *Finance First Approach "seeks to optimise financial returns with a floor for social or environmental impact"* (p. 31) These investors aim at optimising financial returns, whilst observing a pre-defined floor for social returns. The minimum impact objectives have to be achieved by the social entrepreneur, while the financial returns compare with more conventional investments.

In practice, the two different approaches are too blurred for a clear-cut distinction to be made. *"Investors who have the flexibility to invest in either Financial First or Impact First investments achieve different goals. Financial First investments deliver strong risk-weighted returns as well as positive social / environmental impacts, while Impact First investments can trail-blaze, to meet tougher social / environmental challenges by accepting lower returns or taking initial capital risk to allow new types of funds to develop a track record"* (Bridges Ventures & The Parthenon Group, 2010, p. 7). Many Impact Investors therefore claim to fol-

low an *Impact First Approach*, although actually they implement a combined approach – mainly because it makes it easier to attract capital: in view of the positive publicity, investors are more likely to allocate funds if they can profess to the social impact being targeted. On the other hand, investors may state a *Finance First Approach* as part of a fund-raising strategy, at the same time pre-defining financial targets below the achievable market rate in order to increase impact.

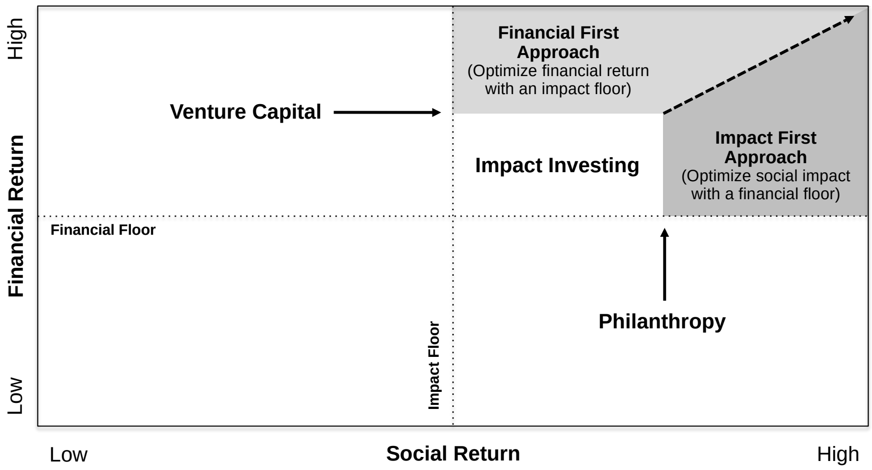

Figure 3: Segments of Impact Investing

Source: Author's illustration based on Freireich and Fulton (2009) and Bridges Ventures & The Parthenon Group (2010)

In practice, the two different approaches are too blurred for a clear-cut distinction to be made. *"Investors who have the flexibility to invest in either Financial First or Impact First investments achieve different goals. Financial First investments deliver strong risk-weighted returns as well as positive social / environmental impacts, while Impact First investments can trail-blaze, to meet tougher social / environmental challenges by accepting lower returns or taking initial capital risk to allow new types of funds to develop a track record"* (Bridges Ventures & The Parthenon Group, 2010, p. 7). Many Impact Investors therefore claim to fol-low an *Impact First Approach*, although actually they implement a combined approach – mainly because it makes it easier to attract capital: in view of the positive publicity, investors are more likely to allocate funds if they can profess to the social impact being targeted. On the other hand, investors may state a *Finance First Approach* as part of a fund-raising strategy, at the same time pre-defining financial targets below the achievable market rate in order to increase impact.

With reference to Figure 3 (p. 22), it is arguable that the desirable objective would be to shift and integrate the two approaches and increase both the financial and social return of Impact Investing. Within the overall investment spectrum, in order to scale up the industry of Impact Investing and increase the social impact generated, this implies that by adjusting their respective returns Venture Capital and Philanthropy would each need to move closer to Impact Investing.

Based on the aforementioned concept of Impact Investing, this paper refers to investors applying this investment approach as Impact Investors. In this context, the term Impact Investors may refer either to individual persons or to institutionalised groups providing capital to social ventures. The range of possibilities available to Impact Investors for balancing their dual objective of social impact and financial returns correlates to the broad focus already observed in social entrepreneurship (cf. Section 2.1).

2.5 Selection Process Model

Similar to Venture Capitalists, Impact Investors must develop specialised abilities, methods and procedures for selecting the projects they invest in. Most importantly, Impact Investors engage in long-term relationships usually with a small number of highly selective social ventures. Impact Investors besides providing financial backing also afford non-financial unremunerated support, and with their common objective of maximizing social impact and generating financial return, both the Impact Investor and the social venture benefit from close collaboration.

Given the novel value proposition in Impact Investing, namely optimising the balance between social and financial returns, no established findings on the specific selection process in Impact Investing and the criteria applied are available to date. Specifically, deal origination and the variables that Impact Investors consider when screening and evaluating social ventures have not yet been distinguished. In view of this, the question is the extent to which the VC selection process is applicable to Impact Investing.

This paper assumes that Impact Investors, similar to Venture Capitalists, face the problem of identifying and selecting the most promising investment opportunities. They both therefore need to apply a highly sophisticated selection process in order to reduce investment risks.

Possible investment risks that the Impact Investor theoretically faces when selecting social ventures are mentioned in the Principal-Agent Theory (cf. Kleinschmidt, 2007, pp. 47ff.; Duffner, 2003). The Impact Investor as the principal has to motivate the social venture as the

agent to act in the investor's best interest and not to strive for its own ends. A conflict of interests will arise if the social venture's interests differ from those of the Impact Investor and the business acts to its own advantage by distributing information asymmetrically: social entrepreneurs might well know more about their venture than the Impact Investor (Adverse Selection). If the Impact Investor lacks vital information, it will be costly if not impossible for it to control the social venture. Moreover, a difference in risk attitude between the Impact investor and the social venture may lead to moral hazard: the social entrepreneur might disagree with the Impact Investor and prefer to act differently, knowing that the costs in the event of failure will be borne by the Impact Investor. Moral hazard is likely to occur moreover if the social entrepreneur's actions and commitment fail to maximize the value of the company subsequent to the investment decision. Finally, the social entrepreneur might blackmail the Impact Investor by threatening to leave the venture, given that the company depends on his own personality, skills and knowledge.

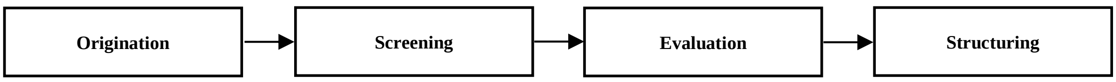

Figure 4: Selection Process Model in Venture Capital

Source: Author's illustration based on Tyebjee and Bruno (1984)

Since no specific established selection process model exists for Impact Investing, this paper refers to the findings in literature on Venture Capital in order to ascertain the extent to which they apply to Impact Investing. Tyebjee and Bruno (1984) proposed the first widely recognized selection process model for VC. Those authors broke down the selection process into four stages: deal origination; proposal screening; proposal evaluation; and deal structuring (illustrated in Figure 4). Since the selection of ventures takes place in the first three phases, the paper waves an in-depth consideration of the final phase: during the structuring phase, the involved parties arrange their engagement after the assessment. For the sake of completion, the paper however refers to the four phases found in literature.

The selection process model shown above may be considered the most widely accepted, and although individual selection processes do differ on a case-to-case basis, it largely serves as a foundation for procedure in current practice. Other models found in literature may be regarded as merely being a refinement – their stages can be traced back to the four stages presented by Tyebjee and Bruno (1984).

2.5.1 Deal Origination

According to Tyebjee and Bruno (1984), there are three possible ways for a deal to originate between the Venture Capitalists (VCs) and the venture: first, the venture establishes contact with VCs directly; second, the venture and the VCs are referred to each other by an intermediary who indirectly initiates contact; and third, VCs become aware of a venture in an active search for appropriate investment opportunities. While the first two channels bring potential deals passively to the attention of the VCs, the third possibility consists of VCs searching proactively for new deals within their network.

The first possibility is for a venture to seek out VCs and establish contact itself. If ventures are to take the initiative and search for investors, it is crucial for VCs to be visible; for this reason, VCs have developed various communication channels, such as publications or event sponsoring. This approach has evolved from awareness of the problem that *"many entrepreneurs seem to know very little about venture capital provision. It appears (...) that many approaches by entrepreneurs* [are] *ad hoc and result from random selection from venture capital fund directories. (…) It* [is] *highly unlikely that they would be successful in gaining funds"* (Sweeting, 1991, p. 610).

Criteria (Dimension)
Venture
Cold call from unknown entrepreneur (Phone, email)
Contact at industry events
Referral Process
Intermediary
Other Venture Capital fund
Portfolio company
Syndication
Active search of Venture Capital funds
Intermediary
Internet
Other Venture Capital fund
Participation in industry events
Portfolio company

Table 1: Deal origination in Venture Capital

Source: MacMillan et. al. (1985); Scarlata & Alemany (2009); Sweeting (1991); Tyebjee and Bruno (1984)

The second possibility for establishing contact is a reference: an intermediary – such as banks, other VCs, investors, personal acquaintances, former investees or consultants – refers the venture and the VCs to each other. As Fried and Hisrich (1994) point out, deals are more likely to succeed if a third party has been engaged: *“First, referred deals are more likely to pass through the generic screen if the VC has confidence in the referrer's judgment. Second, the referrer is more likely to understand what type of investments the VC might find attractive”* (p. 32). VCs tend to prefer this type of deal origination, as the venture had to pass through the filter of being referred.The third possible way for a deal to originate is an active search by VCs for appropriate ventures in which to invest. VCs are meanwhile increasingly resorting to this active approach, on the one hand because competition among VCs is intensifying (Bender, 2011, p. 24), and on the other hand because entrepreneurs encounter difficulties in finding and contacting suitable VCs. Moreover, actively searching for ventures gives VCs a financial advantage: *“(...) by being proactive it* [is] *possible to get a lower deal price than by operating in the open market and passively awaiting requests to come (...)“* (Sweeting, 1991, p. 611). VCs therefore search for deals within their informal network, attend industry events and search for deals on the Internet.

Table 1 (p. 25) summarizes the three possibilities for a deal to originate between the VCs and the venture.

2.5.2 Deal Screening and Evaluation

After contact between a venture and a VC firm has been established, the submitted proposals are screened and further in-depth information is gathered during the evaluation phase, in order to select the investment.

Table 2 outlines the respective criteria found in literature on traditional Venture Capital.

Criteria
Investment size
Core competence
Geography
Stage of financing
Business plan

Table 2: Screening criteria in Venture Capital
Source: Tyebjee and Bruno (1984)

During the screening phase, VCs identify and reject ineligible proposals that clearly do not meet the VCs’ criteria: *“(...) screening criteria reflect a tendency to limit investments to areas*

with which the venture capitalist is familiar (...)" (Tyebjee and Bruno, 1984, p. 1052f.). These criteria provide the basis for a negative screening and constitute the first decision before the fund continues considering the investment proposal and enters a more detailed evaluation of the proposal. The screening phase is thus a pre-selection to reduce the large number of proposals to a more manageable size. Each VC firm has specific, pre-defined criteria on which its screening is based; if these basic requirements are not satisfied on first sight, the proposal is usually immediately rejected. Consulting these criteria therefore increases efficiency within the selection process.

Criteria (Dimension)
Entrepreneur and management team
Education
Experience
Market familiarity
Personality
Venture
Ability to generate profits
Business model and strategy
Consumer orientation
Product / Service
Technology
External Factors
Entry barriers
Market size
Market growth
Market potential for product
Deal
Deal terms
Entrepreneur's stake in venture
Portfolio diversification
Investment size

Table 3: Evaluation criteria in Venture Capital

Source: MacMillan et. al. (1985); Scarlata & Alemany (2009); Sweeting (1991); Tyebjee & Bruno (1984)

Further information is gathered on the investment opportunity during the evaluation phase. The main objective of this phase is to reduce the inherent risks posed by uncertainty and to increase the quality of the investment decision (Heister, 2010, p. 130). The term *due diligence* is often used in this context – the collection and assessment of data for valuing the target

company. During this evaluation, information asymmetry can arise between the venture and the VC firm, because the former might rate the chances of success better than the latter: Ventures *“ (...) want to keep certain information away from the potential buyer until the latest possible moment”* (Parr, 2006, p. 232). To overcome this problem, “*The venture-capital industry has evolved operating procedures (...) that are well adapted to environments characterized by uncertainty and information asymmetries (...)”* (Sahlman, 1990, p. 473). Established procedures support VCs in predicting future performance, reducing the potential for information asymmetry leading to adverse selection. *“Adverse selection arises, as venture capitalists have to rely greatly on information about the enterprise’s state of affairs supplied by the entrepreneur”* (Wright & Robbie, 1996, p. 154). VCs therefore assess the proposal submitted in detail before taking an investment decision. “*For the VCs, the due diligence process is a form of insurance against potential adverse selection (...). The VC can better determine the entrepreneur’s credibility and the viability of the new venture before deciding to invest (...)”* (Arthurs & Busenitz, 2003, p. 150).

In practice, the screening and evaluation phases are likely to occur simultaneously (Heister, 2010, p. 127). The criteria applied by VCs to select their investments have been elaborated in detail in academic literature (Heister, 2010. p. 144ff.). There are four dimensions that VCs mainly consider when selecting their investments: entrepreneur and management team; venture; external environment; and deal characteristics. The literature suggests measuring the dimension of the entrepreneur and the management team through variables such as personality, experience, education, and market familiarity (e.g. MacMillan, Siegel & Narasimha, 1985, p. 121; Kaplan & Strömberg, 2001, p. 428; Smart, 1999, p. 62; Tyebjee & Bruno, 1984, p. 1058; Boocock & Woods, 1997, p. 48). VCs consider variables such as business strategy, consumer orientation, location, product / service, technology, the stage of the venture and the company’s ability to generate profits (e.g. MacMillan, Siegel & Narasimha, 1985, p. 121; Kaplan & Strömberg, 2001, p. 428; Tyebjee and Bruno, 1984, p. 1054). Moreover, external factors are important for VCs, such as: market size, market growth, market position, and entry barriers (e.g. Kaplan & Strömberg, 2001, p. 428; Tyebjee and Bruno, 1984, p. 1054; Hall & Hofer, 1993, p. 37). Finally, VCs regard the deal itself when selecting their investments. Within this dimension, variables such as the size of the investment, portfolio diversification, risk, deal terms, and the entrepreneur’s stake are contemplated (e.g. Kaplan & Strömberg, 2004, p. 2186; Tyebjee and Bruno, 1984, p. 1054).

Table 3 (p. 27) summarizes the dimensions and respective variables found in the literature on VC.

Based on the aforementioned elaborations, this paper applies the selection process model used in VC to Impact Investing, in order to research similarities in the deal origination channels and deal selection criteria, investigate how methods and practices already established in VC are adapted to the needs of Impact Investing, and establish the additional criteria that are applied in Impact Investing.

3 Methodology

In an initial step towards developing a theory, this paper follows an inductive research approach. Since the objective of the study is to find answers to the stated research question – namely, how Impact Investors select their portfolio companies in Latin America – and not to test an existing hypothesis or assess a given theory, propositions are developed in an exploratory process that still need to be tested in further research.

The applied research process combines qualitative and quantitative designs, in order to obtain a holistic understanding of the selection process in Impact Investing. While the qualitative design is applied to monitor basic observations, the quantitative design is employed to identify existing patterns. These patterns in turn provide the basis for the formulation of propositions, which may serve as a basis for a new theory. In order to implement the inductive research approach described, the mixed methods *Exploratory Sequential Design* is applied.

3.1 Mixed Methods Exploratory Sequential Design

This paper follows a mixed method research design. Central to this research design is the combination of different methods: at the most simple level, both qualitative and quantitative methods of data collection and data analysis are mixed in the study. The data are collected either concurrently or sequentially; each form of data is given a certain priority; and the data are integrated at some point in the research process, namely in the phase of collection, analysis or interpretation (Creswell, 1999, p. 456f.; Creswell, Plano Clark, Gutmann, & Hanson, 2003, p. 231ff.).

The objective of the paper is to identify how Impact Investors select their portfolio companies in Latin America, in particular the origination of deals and the selection criteria that are applied. In order to answer the research questions which derive from this, the *Exploratory Sequential Design* is applied. This research design is basically characterized by two phases: qualitative data is collected and analysed during the first phase, followed by a second phase of collecting and analysing quantitative data, as Figure 5 (p. 30) depicts.

Figure 5: Basic Exploratory Sequential Design

Source: Author’s illustration based on Creswell & Plano Clark (2006)

The focus of the study lies on exploring the phenomenon of Impact Investors selecting their portfolio companies in Latin America. The purpose of applying the *Exploratory Sequential Design* is to generalise the qualitative findings obtained from the interviews during the first phase to a larger sample gathered during the quantitative phase (Creswell & Plano Clark, 2011, p. 86). The intention of this two-phase research design is that the findings of the first method are used to develop the second method (Greene, Caracelli & Graham, 1989, p. 259; Creswell & Plano Clark, 2006, p. 75). The premise of the design is that answering the research question requires an exploration. First, the relevant variables driving the process of deal origination and the selection criteria are unknown. Second, there is no instrument available to measure the crucial factors.

The research design begins qualitatively (Creswell et. al., 2003, p. 228) and is useful for identifying the important criteria and for developing an appropriate instrument to study these criteria on a broader basis. The research design enables generalisation of the findings to the identified population of Impact Investors and the identification of patterns for making propositions. There is a possibility that in further research, the stated propositions might be used for developing a generally valid theory on how Impact Investors select their portfolio companies in Latin America.

In detail, the *Exploratory Sequential Design* proceeds as follows. First, a phenomenon is explored by collecting qualitative data. Then the design moves on to a second phase by collecting qualitative data. Developing an instrument to identify the relevant variables, the design builds on the findings achieved during the qualitative phase. This development connects the initial qualitative phase to the subsequent quantitative phase of the study (Figure 6). As the design begins qualitatively, the emphasis normally lies on the data and findings obtained within the first qualitative phase (Creswell & Plano Clark, 2006, p. 77).

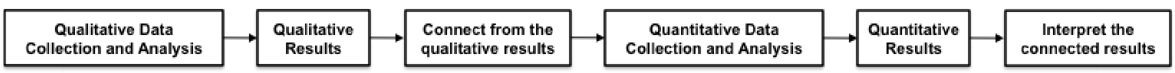

Figure 6: Detailed Exploratory Sequential Design

Source: Creswell & Plano Clark (2006); Curry, Krumholz, O'Cathain, Plano Clark, Cherlin & Bradley (2013)

This paper applies a specific variant of the *Exploratory Sequential Design,* namely the *Instrument Development Model.* The model is characterized by the way it connects the two phases and by its relative emphasis on the two methods (Creswell & Plano Clark, 2006, p. 77).

By conducting in-depth pilot interviews, the research topic of how deals originate and what variables are applied when proposals are assessed was first explored qualitatively. The interviews were of semi-structured type: all interview partners were asked the same set of questions. Where appropriate, minor variations were made to further identify relevant aspects or to lead the conversation. Asking the same questions to all participants enables a comparison of the answers obtained and identification of the relevant criteria. The qualitative findings achieved provided the basis for the quantitative instrument.

The qualitative findings guided the development of a quantitative web-based survey instrument. In the second phase of data collection, the instrument developed is implemented and validated (Creswell & Plano Clark, 2006, p. 77). By developing the instrument, the qualitative and quantitative methods are actually connected. The applied *Instrument Development Model* prioritizes the quantitative method, as indicated by capital letters in Figure 7. The model emphasizes the quantitative model, to test the identified variables of the selection process and to generalise the qualitative findings to the total population of Impact Investors. These two forms of research are integrated during the interpretation phase, i.e. after the qualitative and quantitative data have been collected and analysed. The particular qualitative findings complement the broader quantitative results obtained from the questionnaire. Thus the findings are generalised and tendencies are identified, forming a foundation for propositions to be made.

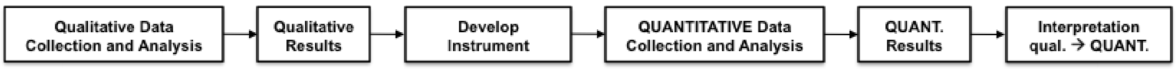

Figure 7: Exploratory Sequential Design – Instrument Development Model

Source: Creswell & Plano Clark (2006)

In summary, the *Instrument Development Model* conducts a qualitative phase followed by a quantitative one. Priority is given to the quantitative aspect of the study. The two methods are connected by developing an instrument. The findings of the two phases are integrated during the interpretation phase. The purpose is to use the quantitative data and results to assist in the interpretation of the qualitative findings. The rationale of this approach is to test and generalise the criteria identified during the qualitative phase by applying a quantitative questionnaire

(Creswell et. al., 2003, p. 229). Finally, the focus of the design is to explore the phenomenon of how Impact Investors select their portfolio companies in Latin America.

Following the approach taken by Scarlata and Alemany (2009) in their research, this paper uses the *Exploratory Sequential Design* approach in order to exploit the advantages created by the two-phase structure and the fact that only one type of data is collected at a time (Creswell & Plano Clark, 2006, p. 78). First, the separate phases simplify the task of describing, implementing and reporting the research. Second, the design enables an expansion on the qualitative findings and further in-depth exploration of the phenomenon being researched. Third, the structure of the design enables and simplifies the development of an instrument for the quantitative phase (Creswell et. al., 2003, p. 230). Finally, the design combines the advantages of both research methods: by conducting interviews, the study manages to acquire the depth, richness and detail of qualitative research; simultaneously, the study acquires the breadth of data and generality obtained by collecting a larger amount of data during the quantitative phase. By applying these two different methods, the disadvantages of each respective one are thus neutralised within the study.

3.2 Data

The data collected for the study was obtained first by conducting interviews and second by distributing an anonymous web-based questionnaire among the entire population of identified Impact Investors.

Eight Impact Investors from Brazil, Costa Rica, Mexico and Switzerland were interviewed either face-to-face or via Skype during May 2013. The interviews outlined how deals are originated and what criteria are applied when considering a proposal from a social venture in Latin America. The interview partners in general were chosen to provide a broad perspective on the topic of Impact Investing, i.e. to reflect the various backgrounds of the investors that may either come from one of the two concepts of Venture Capital or Philanthropy. Moreover, the interview partner from Switzerland was chosen, in order to obtain an international perspective and to take credit to the author's background. Moreover, the Swiss interview partner engages heavily in the Impact Investing industry in Latin America, knowing the relevant factors to consider when selecting a social venture. Another mentionable interview partner is ICE, which was chosen due to the former philanthropic background[7]. The interviews lasted between 30 and 60 minutes. With the permission of the Impact Investors, all the interviews were

[7] For a detailed description of the interview partners and their resp. background please refer to Appendix A1

recorded. After the interviews, the recordings were transcribed to Word files. The interview partners agreed to provide information, to being named in the list of references and to being quoted anonymously. They strictly emphasized not being quoted directly, because of the confidential and strategic nature of the information given: specific statements should not be attributable to a particular person or institution. After this paper was completed, the interview recordings were therefore deleted for data protection reasons.

The findings obtained from the in-depth interviews provided the basis for compiling an anonymous web-based questionnaire. Impact Investors selecting criteria in the questionnaire were asked to indicate the relative importance in each case. Funds were not required to indicate their identity in the questionnaire, since the questions again asked for information likely to be considered confidential and strategic. Measures were taken to reduce Impact Investor's constraints possibly causing reluctance to fill in the questionnaire. After a pilot run, the questionnaire was distributed among the entire identified population of Impact Investors who are active in Latin America, i.e. engaged with a portfolio company in that region. In total, 90 Impact Investors were identified who met these criteria. The population of Impact Investors was mainly identified by consulting the *Impact Assets 50* and the *Impact Base* databases; Internet research and personal networking also contributed to the list of contacts.

After the interviews had been conducted in May 2013, the web-based questionnaire which had been prepared was distributed via email amongst the Impact Investors at the beginning of June 2013. The potential respondents were allowed four weeks to submit the completed questionnaire online. Impact Investors who had failed to respond within two weeks were sent a reminder by email and again asked to participate in the study.

Contrary to expectations, only 13 Impact Investors actually completed the entire questionnaire, which is equivalent to a response rate of approx. 15%. The survey thus provided only a small data sample – a response rate of 15% does not allow for a sound statistical analysis. Nonetheless, the very varied feedback from the fund managers who replied to the request by email indicates that the relatively low response rate did not necessarily reflect a low level of interest in the research being conducted: indeed many – some of whom did not actually take part – expressed their appreciation and gave encouragement, whilst others commented that the questionnaire was detailed and thorough. A number of fund managers replied to the email but declined to participate in the survey, referring e.g. to regulatory and compliance issues. Some fund managers commented on the strategic nature of the questions. Thus 46 Impact Investors started filling in the questionnaire, but did not then complete it – they evi-

dently reached a point at which they preferred not to disclose further information that they considered confidential and strategic for their fund. Other Impact Investors confirmed by email that they did not take part simply due to heavy schedules or limited resources.

As the 13 full responses received only provide an insufficient data sample, the initial intention of gathering a broad data sample for performing a quantitative analysis had to be put aside; instead, the results obtained from the questionnaire together with the outcome of the eight interviews conducted in person or via Skype were subjected to a qualitative interpretation. This approach ensured that the results from the questionnaire – despite their size – were actually utilised. Against this background, the overall empirical findings have to be regarded as trends and interpreted as indications of how Impact Investors currently select their portfolio companies in Latin America and of the criteria they apply, rather than treated as generally and universally valid results.

4 Empirical Findings

The following section presents and interprets the empirical findings of the study, incorporating the data collected during the qualitative and quantitative research. Unless stated otherwise, the insights are based on the aggregate findings of the personal interviews and the online questionnaire. As already stated, the overall empirical findings have to be regarded as trends and interpreted as indications.

The structure of this section is based on the selection process model of Tyebjee and Bruno (1984) presented above (cf. Section 2.5). First, the deal origination criteria are described, outlining how proposals from social ventures reach the attention of Impact Investors. Second, the criteria for selecting portfolio companies that Impact Investors apply during the screening and evaluation phases are identified, whereby only those most relevant are analysed in detail.

4.1 Deal Origination

There are two possibilities for Impact Investors to learn about a potential deal: deals may originate passively (social entrepreneurs contact the Impact Investor and submit an unsolicited proposal directly) or actively (funds search for investment opportunities). The active and passive deal origination methods observed in Impact Investing were identified, compiled and interpreted on the basis of the data collected.

4.1.1 Passive Deal Origination

The first possibility involves entrepreneurs submitting their proposals unsolicited. Impact Investors can open up various communication channels, e.g. in networks and the Internet, to

encourage passive deal origination. Table 4 (p. 36) depicts the different categories of methods used in this context.

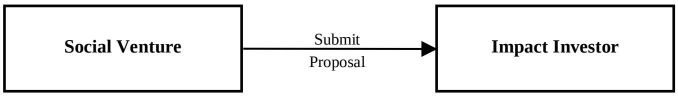

Figure 8: Passive Deal Origination in Impact Investing

Source: Author’s illustration

4.1.1.1 Networking

Impact Investing in Latin America is a closed industry in which investors and social entrepreneurs have to make a name for themselves. Building up a reputation and a network of trust and appreciation within the sector is of utmost importance, especially if funds are to obtain unsolicited proposals. Thus it is all about branding and reputation: *“We managed to bring the (...) name out on the market as a venture incubator for social projects. (...)* [Market participants] *know that we invest into a certain type of investments and then try to call our attention. (...) Word of mouth is most important”* (N.N., Interview, 2013a). And a good reputation on the market increases the number of proposals an Impact Investor receives: *“Some entrepreneurs do proactively approach us. The number has been growing every year, since we have built up a reputation on the market and got more and more known (...)”* (N.N., Interview, 2013f).

Impact Investors most commonly attend industry events, such as conferences, in order to make themselves well-known on the market, build up a personal network and increase the possibility of being sent unsolicited proposals from social entrepreneurs. In terms of passive deal origination, conferences are most likely to bring social entrepreneurs to the attention of Impact Investors: *“We get to know a lot of social entrepreneurs by attending conferences. (...) We often participate in such events. Usually, after a panel discussion, there are several social entrepreneurs waiting for us”* (N.N., Interview, 2013b).

Moreover, deals passively originate in Impact Investing by Impact Investing funds approaching and referring each other as co-investors. Again, a good network and reputation are prerequisite. This method is regarded as most important: Impact Investors engage with *“ (...) other funds in the field, which are actually willing or open to co-invest. With such funds we are in tight contact and they often approach us (...)”* (N.N., Interview, 2013c). “[Name W[8]] *receives a lot of projects. Since we have a good relationship with them, we re-direct projects to each*

[8] In the following, names mentioned in the interviews are anonymized by using capital letters.

other. Again, it's all about the network (...)" (N.N., Interview, 2013a). Obtaining a referral as a co-investor is highly appreciated, since the proposal and the respective social entrepreneurs are likely to have already passed initial screening. Moreover, Impact Investors have confidence in each other's judgment and with their collective engagements they build up a track record.

Factor	*n*	*%*	*RI*
Networking			
Attendance at industry events	11	85%	4.09
Other funds contact fund as potential co-investor	10	77%	4.60
Entrepreneurs are redirected through an investor	10	77%	3.90
Entrepreneurs are referred to fund by portfolio company	8	62%	4.13
Advisors contact the fund on behalf of entrepreneurs	8	62%	4.00
Fund engages in research with universities, research institutions, etc.	4	31%	3.50
Internet			
Entrepreneurs establish contact through fund's web-page	10	77%	3.60
Entrepreneurs send unsolicited proposal by email	8	62%	3.75
Entrepreneurs establish contact through third-parties' match-making platforms / programs	3	23%	3.00
Miscellaneous			
Cold calls from Entrepreneur	7	54%	3.57
Entrepreneurs react on fund's public activities	5	38%	3.20
Entrepreneurs react on fund's call for bids	2	15%	4.00
Entrepreneurs are discouraged to send unsolicited proposals	0	0%	n/A
Entrepreneurs do not contact fund	0	0%	n/A
Other			
Entrepreneurs apply to accelerator program	1	8%	(5.00)

Table 4: Passive deal origination in Impact Investing

Source: Author's elaboration

It is not unusual for deals to originate through a referral from the fund's own investors or a recommendation from existing portfolio companies. Although the former possibility is more likely to occur, the latter is regarded as more important, because a resultant deal then originates directly from the entrepreneur's own network. A proposal suggested by a well-known portfolio company is generally considered to be promising, because the proposal already had to pass the assessment of the referring portfolio company. Impact Investors therefore increasingly start asking their existing portfolio companies to recommend deals that originate from among their peers.

Advisors are another significant source for passively originating deals. Social entrepreneurs' advisors constitute an important element within the network of Impact Investors. Funds passively originate deals by being contacted by advisors on behalf of social entrepreneurs. However, since advisors demand some financial remuneration, only financially strong or already well-established social entrepreneurs are able to use this channel for getting in touch with funds and for deal origination. *"There are* [social entrepreneurs] *that are large enough and have the financial resources to get an advisor – this advisor in turn gets in touch with us as an Impact Investing fund"* (N.N., Interview, 2013d).

Finally, universities and research institutions form another element in the Impact Investing network, although funds have not experienced these parties as a major source for passively originating deals. A few Impact Investors have increased their publicity by engaging in academic research, but obtaining unsolicited proposals from academic quarters is more likely to occur by chance. One reason why academia is not recognized as a major player fostering passive deal origination may be the fact that universities investigate the phenomenon of Impact Investing per se and publish their research, rather than becoming actively involved in related professional services.

4.1.1.2 Internet

Entrepreneurs use various networks and platforms in order to identify and establish contact with Impact Investors, increase publicity and promote their projects. Thus the Internet is an important communication channel: *"People looking for funding for their social projects contact us mostly through the Internet"* (N.N., Interview, 2013a). In the study, three ways were identified in which the Internet contributes to passive deal origination for Impact Investors.

First, entrepreneurs often identify and directly approach Impact Investors through the fund's website. Some funds provide a special platform on their website where entrepreneurs can upload their proposals: *"Entrepreneurs do proactively use the internal info-channel, which is on our website"* (N.N., Interview, 2013c). The platform distributes incoming proposals to the responsible department for an efficient assessment of the documents submitted. Although Impact Investors receive numerous proposals from entrepreneurs via this channel, the proposals thus submitted are often to lower standards, so deal origination through the Internet is therefore regarded as less important. Nonetheless, due to the impersonal character and ease of this approach, entrepreneurs more frequently opt for this solution than for email contact (see under).

Second, entrepreneurs frequently take the initiative and contact Impact Investors directly by email. Funds often have special email accounts for receiving proposals: *"Entrepreneurs are able to contact us through our website – we have a specific email on our website that entrepreneurs can use to get in touch with us and to send their projects"* (N.N., Interview, 2013f). Impact Investors receive fewer proposals by email than via the special platform on their website; nonetheless, this channel is considered more important – writing an email calls for greater personal effort and involvement, in addition to which the proposals received tend to be better deliberated and of higher quality.

Finally, entrepreneurs establish contact with Impact Investors through matchmaking platforms or programs provided by third parties. In the context of passive deal origination, matchmaking platforms introduce entrepreneurs to Impact Investors. These platforms aim to search for the best matches and pinpoint areas that coincide. However, Impact Investors do not regard this channel as being particularly important and only a few funds have been contacted on behalf of entrepreneurs. Confidentiality and reliability when initiating and establishing contact is regarded as crucial – third parties have to be reputable and trustworthy and guarantee a certain quality standard. Yet entrepreneurs bear the costs involved and make use of the services provided, because personal contact is established and introduction into the network is facilitated.

4.1.1.3 Miscellaneous

Besides the possibilities presented above, there are various other ways Impact Investors can passively obtain unsolicited proposals from entrepreneurs. In the study, while three alternative channels were identified in the personal interviews that were conducted, participants answering the questionnaire mentioned two additional methods.

Some Impact Investors experienced entrepreneurs establishing personal contact directly by phone without prior announcement, although this approach occurs relatively seldom and funds attach only minor importance to this possibility. *"We* [do] *get a little bit of cold calling"* (N.N., Interview, 2013b). Giving an Impact Investor a cold call appears less attractive, given the opportunity to submit proposals in detail through the fund's website or to write a personal email without the pressure of the moment. Moreover, for calling a fund manager with the objective of submitting a proposal, an entrepreneur requires marked communication skills.

Impact Investors can act publicly to increase their reach and encourage unsolicited proposals from entrepreneurs. Advertising in trade journals, event sponsoring, report writing and suchlike contribute towards an Impact Investor's profile among entrepreneurs. However, this ap-

proach is not widely adopted and is regarded as relatively unimportant, because it targets the Impact Investor's message towards a wide audience rather than towards a specific entrepreneur.

Finally, Impact Investors sometimes call for bids from entrepreneurs: funds intending to finance an Impact Investing project ask for bids, in order to obtain competing offers from different entrepreneurs willing to enter an engagement and sign a contract with the fund. An Impact Investor can receive numerous proposals merely by inviting entrepreneurs to participate – this saves a time-consuming and costly research process. Impact Investors tend to resort to this method when entering the market, setting up a new fund, or looking for engagements in a specific area. However, a detailed assessment of the proposal finally chosen still has to be done.

The Impact Investing industry is relatively small and personal connections prevail; the various parties build up a reputation on the market and do not hesitate to refer to each other. Impact Investors also encourage entrepreneurs to contact them and to submit their proposals, because the funds do not want to exclude any business opportunities that may emerge. As the quantitative findings in this study show, all the Impact Investors who participated had already been approached by an entrepreneur at some point in time – the author did not meet a single Impact Investor who had no experience in this respect.

4.1.1.4 Other

In the web-based questionnaire, Impact Investors were asked to indicate additional methods used in practice to obtain unsolicited proposals from entrepreneurs. The answers received indicate that entrepreneurs apply to accelerator programs that Impact Investors launch to receive proposals. In these programs, the Impact Investor launches an application procedure to which different entrepreneurs respond, competing with each other for the fund's engagement – i.e. an investment and non-financial support. Specifically, a small number of specially selected social entrepreneurs attends an exclusive event, where they present their reciprocal business ideas and evaluate and assess each venture's potential for achieving the dual objective – the two best-ranked entrepreneurs are then funded by the Impact Investor. Thus the Impact Investor passes on the task of screening and evaluating investment proposals to the entrepreneurs, making use of their in-depth knowledge and expertise. Such accelerator programs adopt and monitor elements used in the Venture Capital approach: clearly defined action plans are implemented, the Impact Investor takes an active role in the social venture's management, mentoring services are provided, and the fund gives access to business connec-

tions and networks. Impact Investors tend to back management teams in social ventures, rather than individual entrepreneurs: the workload in undertakings of this kind is assumed to exceed the capacity of a single person. Notably, the respondents who use accelerator programs rated this method as very important – an obvious finding, since any other rating would cast doubt on the rationale of making the effort; the importance rating here should therefore be interpreted with precaution.

4.1.1.5 Interim Findings

The above review of passive deal origination reveals the small nature of the Impact Investing industry, where networks and connections are of huge significance. Only Impact Investors who have built up a reputation, established a network of personal contacts and made a name for themselves in the market are likely to receive qualitatively good proposals and succeed in passive deal origination. *"It's all based on personal connections and bridges that are built in the industry (...)"* (N.N., Interview, 2013a). *"We* [receive] *a lot of deals from our own reputation in the field"* (N.N., Interview, 2013b). *"It's all about networking and personal contacts"* (N.N., Interview, 2013g). Hence in Impact Investing, access to existing networks is the key to passive deal origination. Although the Internet is regarded as an alternative network and the importance of attending events is recognized, it is through personal connections that the most promising proposals are likely to be allocated to the most appropriate Impact Investor.

Moreover, Impact Investors do not necessarily regard passive deal origination as a very reliable source of rewarding engagements. *"(...) entrepreneurs do contact us, but our experience in this respect is not so good"* (N.N., Interview, 2013c). Some Impact Investors are therefore cautious about entrepreneurs approaching them passively. In actual fact, it is no easy task for Impact Investors to attract eligible social entrepreneurs. *"(...) such people who launch a social enterprise are very well prepared and have mostly very good networks. This kind of entrepreneur is not actively looking for investments. (...) It becomes more a beauty salon, where investors identify an opportunity and present themselves more proactively than the entrepreneur would otherwise"* (N.N., Interview, 2013c).

Another aspect also needs to be considered. While Venture Capital merely focuses on financial returns, Impact Investing – which is likewise performance-based – adds the social dimension. Since the main objective in Impact Investing is to achieve both social and financial returns, funds often prefer to actively search for promising social ventures which have the capacity to achieve those dual objectives. Thus passive deal origination becomes a less satisfactory approach and Impact Investors tend instead to start searching proactively for deals and

for those social entrepreneurs who have the potential to achieve the fund's objectives on both counts. Impact Investing funds therefore have their own departments specialised in researching potential deals (cf. Section 4.1.2.2).

Overall, the findings indicate that Impact Investing is similar to Venture Capital in terms of passive deal origination, but that the personal component acquires vital significance: personal contacts, access to networks, attendance at industry events and a high profile are crucial factors in Impact Investing in Latin America.

4.1.2 Proactive Deal Origination

In the second form of deal origination in Impact Investing, funds proactively search for proposals from social entrepreneurs. The measures undertaken to this end can be grouped in two categories: Networking, and Miscellaneous. Table 5 (p. 42) lists the measures identified and allocates them to the appropriate category.

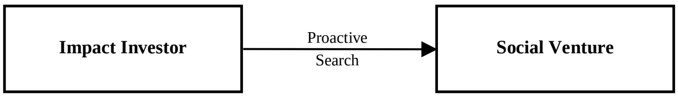

Figure 9: Proactive Deal Origination in Impact Investing

Source: Author’s illustration

4.1.2.1 Networking

Impact Investors proactively searching for deals with social ventures in Latin America have to consider the personal component. Here again, it is important to have access to the relevant networks, to know the key persons and to build up a good reputation: *“(...) We have a very large network. (...) We have over* [No.] *key partnerships, which are not necessarily just informal alliances (...)”* (N.N., Interview, 2013b).

Since personal contacts and network access are crucial, Impact Investors actively participate in industry events where the market players come together and social ventures can be approached. Most Impact Investors regard events as important opportunities: *“(...) we contact the respective parties that we meet at conferences and at general events on Impact Investing and entrepreneurship. There we find a lot of people who work on projects that suit our investment criteria”* (N.N., Interview, 2013a). Industry events where Impact Investors actually search for promising social ventures therefore present one of the main possibilities for proactively originating deals.

The second possibility to which Impact Investors frequently resort is their own business network: Impact Investors approach other funds as well as their own investors or portfolio com-

panies, aiming to get referred to social ventures. *“We speak to potential local networks, where we know people who in turn have knowledge about the sector and can probably introduce us to potential entrepreneurs.* [Moreover] *(...) it makes sense that* [investors and portfolio companies] *provide us support in finding more potential entrepreneurs, as they often participate in events. (...) if* [their] *representatives (...) participate in industry events, they mention* [Name X]*, and if somebody is interested they introduce us to them”* (N.N., Interview, 2013c).

Factor	*n*	*%*	*RI*
Networking			
Participation in industry events	10	77%	4.40
Business network of funds and investors	10	77%	4.30
Existing portfolio companies	7	54%	4.00
External matchmaking platforms	3	23%	3.67
External advice from agencies or consultants	2	15%	4.00
Miscellaneous			
Research	8	62%	4.38
Cold calls to entrepreneurs	6	46%	4.00
Business incubation	5	38%	4.20
Universities and research institutions	5	38%	3.40
Government authorities	3	23%	3.33
Submission of bids / tenders	2	15%	3.50
Foundation of new social venture	1	8%	(5.00)

Table 5: Proactive deal origination in Impact Investing
Source: Author’s elaboration

Impact Investors sometimes use external matchmaking platforms and programs. However, in view of the similarity of the approach these platforms take, no great importance is attached to this possibility because it does little to add value to an Impact Investor’s own activities. Matchmaking platforms can provide access to networks and establish personal contacts, but the services provided incur extra costs: a fee is normally charged for outlining areas of similarity, for matchmaking and for arranging introductions. Impact Investors are likely to manage this on their own, on top of which they can limit the risk of poor investment by making their own assessment once contact is established. To justify the extra cost, matchmaking platforms therefore need to offer an Impact Investor some unique value proposition. One reason why Impact Investors do sometimes rely on matchmaking platforms’ services is the additional filter they apply during the origination process, increasing the quality of the proposals – provided the platforms work to high standards.

Finally, Impact Investors very occasionally contact external advisors and consultants in their active search for entrepreneurs and in order to originate deals. As for external matchmaking platforms, the above considerations also apply to advisors and consultants – they have to offer some added value to the Impact Investor to justify the additional costs.

4.1.2.2 Miscellaneous

Besides networking and maintaining personal contacts, Impact Investors can proactively conduct research to find potential social ventures for promising deals in Latin America. Some Impact Investors have specialised departments focusing on research: *"We have a team of* [No. of persons] *that is mainly focused on finding deals. They are always (...) doing research, in order to find deals"* (N.N., Interview, 2013f). Impact Investors regard conducting their own research as an important element, but proactively originating deals in this manner requires financial and human resources and it is likely to be done only by funds that have achieved a certain size.

Contrary to expectations, a number of Impact Investors make cold calls after identifying social ventures on the Internet, in newspapers, at industry events, etc. which have the potential to achieve their dual objectives. This channel of proactive deal origination is used by Impact Investors who have recently entered the market. *"(...) when we were new in the market, we tried to make cold calls to companies. We mainly investigated these companies through their web pages and then made cold calls"* (N.N., Interview, 2013c).

Business incubation is also found in Impact Investing. In business incubation, programs are designed to foster the development of social ventures. Impact Investors provide non-financial support in the shape of mentoring services, similar to accelerator programs (cf. Section 4.1.1.4). However, business incubation goes into more depth: an external management team engages with the social venture to manage and promote the company. Business incubation also covers a longer period of time because the social venture is given support during consecutive phases, and larger amounts of capital are required. An Impact Investor's ability to provide business incubation to social ventures therefore depends on the fund's resources. Nonetheless, a few Impact Investors do offer business incubator programs and consider the approach important for proactive deal origination.

Some Impact Investors proactively contact and collaborate with universities and research institutions in order to originate deals. *"We also found deals through academia, namely through academic persons that were working in this area* [Impact Investing], *such as* [Name Z]*"* (N.N., Interview, 2013e). In particular Impact Investors wanting to promote research in order

to encourage cooperation between social ventures and academia are likely to find deals in this way, but generally speaking Impact Investors do not attach great importance to this channel.

Government authorities are another player Impact Investors consider contacting for proactively originating deals, even through this possibility occurs seldom and is considered less important: *"we do contact government authorities"* (N.N., Interview, 2013g). Contacting government authorities goes back to the philanthropic concept underlying Impact Investing, namely the desire to mitigate prevailing social problems which the state has failed to solve. Government authorities in Latin America are bound to know which sectors are obviously in need of investment, such as Education or Health. They therefore function as intermediaries, helping to allocate Impact Investing funds to social ventures that can create social value and contribute to the development of those sectors.

Some Impact Investors indicated in the online questionnaire that they respond to invitations for bids or tenders from social ventures. Assuming that a promising social venture with a sound business model and high potential for achieving the dual objectives calls for bids or tenders from Impact Investors, funds in proactively presenting themselves will effectively be competing for the social venture. However, this possibility of proactively originating a deal seldom occurs and is not rated as being very significant.

Finally, Impact Investors always have the possibility of founding a social venture themselves. However, although funds do very occasionally follow this approach, they do not regard themselves as active founders: *"We are no entrepreneurs. (...) we do not create enterprises, because otherwise there would be no room for an Impact Investing fund (...) there would be no entrepreneurial activity (...)* [which] *would prove that the concept is not right"* (N.N., Interview, 2013f).

Impact Investors question their own business model if it fails to manage to trace eligible social ventures. Moreover, Impact Investors want to engage in social ventures that have their origins in the field and the ability to connect to the local community: *"We do not want to help build up an enterprise. Because if an entrepreneur brings up a project, they have a pretty clear idea of what the venture has to look like. And in the end, it's going to be them running the venture"* (N.N., Interview, 2013a). The social venture is thus regarded as a bridge to the community being served or to the sector needing development.

4.1.2.3 Interim Findings

The above review of proactive deal origination again reveals the small nature of the Impact Investing industry, and the importance of networks and connections again becomes obvious. Generally speaking, Impact Investors prefer to search actively for attractive and promising social ventures, rather than passively receive unsolicited proposals: *"(…) we do not sit at our desk and wait for someone to contact us. We are always on the market looking for deals – and the best deals are the ones that we find"* (N.N., Interview, 2013f). Moreover, active deal origination is more rewarding than passive: *"The best company in our portfolio so far is one that we went after"* (N.N., Interview, 2013f). Of the possibilities for proactive deal origination, the network and industry events are rated most highly, because Impact Investors need good personal connections with their investors, portfolio companies and other funds in order to find attractive and promising social ventures. Apart from which, since people involved in Impact Investing meet at industry events that attract further market participants, attendance on these occasions is almost compulsory.

Other proactive approaches such as cold calls are less rewarding: *"(…) the rate of effectiveness has been quite poor with the cold calls, but rather good on a network or event basis. In other words, with all the* [conducted] *research (…), seeking to find potential entrepreneurs on the Internet or by reading newspapers, I have hardly managed to come up with an interesting organisation. (…) On the other hand, if I look at the deals that originated within our network (…) or that I got to hear about during events, this has been more successful. So networks and events are a more promising channel"* (N.N., Interview, 2013c).

A comparison of efforts at proactive deal origination in Impact Investing and Venture Capital reveals great similarity in both approaches. Impact Investors and Venture Capitalists rely on their proactive search for rewarding deals, aiming ultimately to obtain a competitive advantage by succeeding in finding one of the most promising social ventures. Since entrepreneurs often find it difficult to approach funds appropriately, both investment disciplines tend to increase their active efforts to originate deals themselves. In Impact Investing in Latin America however, the personal element, is a far more crucial factor, reflecting the still small nature of this relatively young branch of industry in that region.

4.2 Deal Screening and Evaluation

Once Impact Investors have established contact with promising social ventures, the investment proposals submitted are first screened and subsequently evaluated in-depth if considered

worthwhile. In practice, the two phases of screening and evaluation are likely to occur simultaneously.

4.2.1 Deal Screening

Impact Investors receive numerous proposals. The ones clearly not satisfying the fund's investment policy have to be efficiently identified and promptly rejected during the screening phase. Impact Investors therefore apply very basic criteria to ascertain whether the proposals received are eligible in the first place. In this pre-selection, only those proposals are picked out that will be further considered for an investment and subsequently evaluated in depth.

4.2.1.1 Criteria

Impact Investors most frequently regard the stage of financing as a screening criterion. Capital may be provided to a social venture at various points in time during its life cycle. However, it is likely that other factors – such as a fund's specific risk preferences, or the social venture's impact focus – will determine the stage at which capital is injected. In effect, this criterion is not very different from the approach in Venture Capital.

Every Impact Investing fund has individual limits as regards investment volume, which depend on various factors such as risk appetite, portfolio diversification, or available financial and human resources. The amount of capital the social venture requests thus has to accord with the investment volume an Impact Investor is willing to provide. Although investment volume is a flexible and situational criterion, it is generally regarded as highly important in Impact Investing – similar to Venture Capital.

The impact focus of a social venture is another frequently applied criterion which Impact Investors regard as highly important: the social venture must be in a position to achieve a competitive advantage in its field of operation, taking various factors on the market into account, such as the number of competitors or the market size. Ultimately, the impact focus of the social venture provides the basis for generating both a financial return and social impact. Hence the impact focus implies operation in a profitable area where value can be created for society. It should be noted that impact focus in terms of a social venture's field of operation is an important criterion specifically applied in Impact Investing.

Criteria	*n*	*%*	*RI*
Stage of financing	11	85%	4.73
Investment volume	10	77%	4.90

Impact focus	10	77%	4.90
Social relevance	10	77%	4.80
Core competence	8	62%	4.75
Geographic location	7	54%	4.13
Business plan	7	54%	4.57
Financial structure	1	8%	(5.00)
Management team	1	8%	(5.00)

Table 6: Screening criteria in Impact Investing

Source: Author's elaboration

Moreover, Impact Investors also consider the social relevance of the services that social ventures offer on the market. This criterion infers that the community actually uses the services provided, that social value is generated, and that the consumer is empowered to improve his situation, implying that the community's needs become less urgent. To this end, the social venture has to define clear values and objectives and align its organisation accordingly. Social relevance is another criterion specifically applied in Impact Investing.

The core competencies of a social venture – namely its main strong points and strategic advantages – have to be outlined if Impact Investors are to further consider the proposal for an investment: they need to know what the social venture will achieve and how it will generate social value and a competitive advantage. A social venture must feature some kind of special knowledge and capacity that will enable long-term success in terms of generating financial returns and social impact. Its core competencies ensure that it can successfully enter the market and benefit customers, consequently they should not be easily replicated by would-be competitors (cf. Section 4.2.2.1). Venture Capital likewise considers a venture's core competencies, but Impact Investing assesses whether they will be able to benefit the consumer and improve social conditions.

Impact Investors and Venture Capital both consider a social venture's geographic location during screening, but the former is more likely to focus on a certain region's development and on contributing towards solving social problems prevailing there. Impact Investors also attach importance to close during an active engagement, and expect to meet the management team of their portfolio companies on a regular basis and get a certain overview of the social venture's activities.

Impact Investors expect some documents to be submitted for initial screening – business plans in particular are considered important, because they list the basic ideas, approaches and goals. Besides providing background information on the management team and the target market,

business plans also present the objectives of the social venture, describe how defined goals are to be realised, and outline how a competitive advantage is to be achieved on the market and how the customer is to benefit. Proposals for social ventures which hand in inadequate business plans are likely to be rejected early during screening. Social ventures providing a business plan signal commitment, supporting the assumption that they will be more likely to succeed in realising their business idea. Moreover, good documentation helps the entrepreneur and the management team to structure ideas and serves as a planning instrument. Nonetheless, the attitude in Impact Investing towards assessing business plans during the screening phase is ambivalent, and the necessity of doing so is questioned: some Impact Investors are aware that family-owned or young social ventures in Latin America might not have the resources to provide detailed documents, and sometimes they will even assist the management team with drafting a business plan. “[At the beginning] *we do get something short, in terms of a presentation or concept paper. But it is not a business plan. We are going to develop that later”* (N.N., Interview, 2013b). Compiling a business plan in cooperation with the social venture is just one kind of non-financial unpaid support in Impact Investing, and an example of how Impact Investors make an effort to build up a close and long-term relationship with the social venture.

Finally, the online questionnaire gave Impact Investors an opportunity to indicate further criteria that are assessed during the screening phase. Surprisingly, some funds request information on the social venture’s financial structure or management team even during the screening phase – a request for such detailed information would normally be anticipated during the in-depth evaluation. However, the responses obtained indicate on the one hand that Impact Investors focus early on a social venture’s overall use of long-term debt and equity to finance the business, taking risk considerations into account, and also review the financial structure which will determine the amount of the social venture’s cash flow that is distributed among the various stakeholders. In addition, since good personal relations are an essential prerequisite for successful cooperation, Impact Investors also regard the management team as a further criterion, and personalities and attitudes are taken into account during the screening phase.

4.2.1.2 Interim Findings

Comparing the criteria that are applied during the screening phase in Impact Investing and Venture Capital respectively, similarities between the two concepts become obvious, although the degree of similarity ranges from only slightly to quite market.

First, Impact Investing applies the same criteria as Venture Capital, such as stage of financing or investment volume – there are no notable differences between the two concepts as regards portfolio diversification or risk considerations. Second, Impact Investing has adopted some criteria from Venture Capital, such as focussing on core competencies, considering the geographic location or requiring business plans. However, Impact Investing adds a social component to these criteria, such as social relevance and impact focus, which reflect the influence of Philanthropy and clearly distinguish Impact Investing.

Overall, the screening criteria applied in Impact Investing are an expression of the industry's dual objectives, because as early as the pre-selection phase Impact Investors assess a social venture's ability to generate financial returns and social impact: *"(...) before we do any* [in-depth] *analysis of a company, we look into the sustainability of the social model. The positive social impact has to be part of the company's strategy and business model. This is important, because we need to ensure that once this company grows, the potential for social impact grows as well. So the financial return is due to the social impact achieved. (...) What we want to see is that the more the company grows, the more the company makes money, the more the company helps people"* (N.N., Interview, 2013b).

4.2.2 Deal Evaluation

After proposals have passed the screening phase, further information is gathered on the investment opportunity and the evaluation phase begins. Impact Investors have to accept the fact that social ventures might not have a long operating history; and the family-owned businesses in Latin America might be unable to provide the required documents. Impact Investors therefore have to rely on a subjective assessment of criteria grouped in the following dimensions identified in this study: entrepreneur and management team; social venture; product[9]; external factors; and deal features (cf. Figure 10, p. 50).

[9] The term *product* is used in the following for both goods and services provided by the social venture.

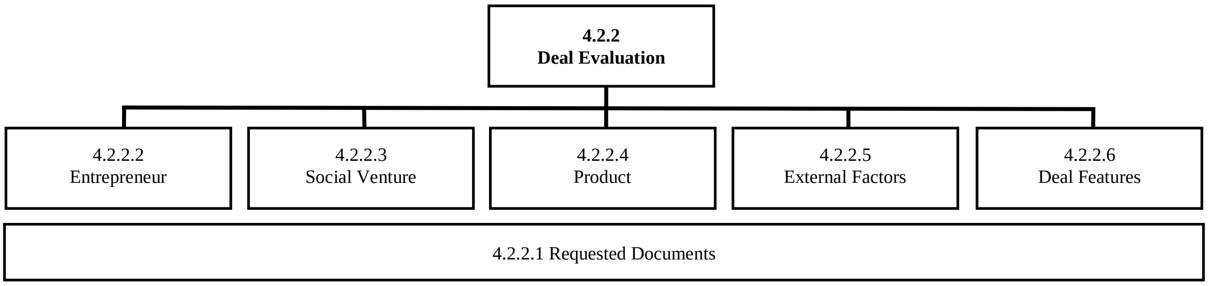

Figure 10: Dimensions for deal evaluation in Impact Investing

Source: Author's elaboration

4.2.2.1 Requested Documents

Impact Investors aim to assess the basic characteristics of a social venture and thereby determine its ability to generate financial returns and social impact. Specific supportive documents are therefore requested for evaluation purposes that relate to the criterion in the respective dimension being considered. These documents are in different categories, as shown in Table 7 (p. 51).

Basic documents are required that introduce and present the main features of the social venture. A presentation tool is used to show that the entrepreneur and his team are motivated, possess the required expertise to run the social venture and have the ability to customize their talk to specific target groups; this can also serve as a basis for further discussions. Often an additional concept paper containing general information, statistics and arguments is required to spark further interest and to demonstrate that the proposed concept is worth investing in. These two basic documents ensure that the persons responsible are able to break down their ideas into the main arguments and present them in a concise, coherent and convincing way.

Impact Investors require historic financial data from social ventures. Funds are interested in a social venture's historic budgeting in order to ascertain whether the company has managed to operate soundly in financial terms. In most cases, financial statements have to be provided, not always necessarily audited. Balance sheets are also considered, providing an overview of assets and liabilities. From the balance sheet the Impact Investor can also do various analyses and for instance determine whether the social venture will be able to repay its debts as they fall due. Annual reports provide additional information, such as the social venture's strategic planning to date.

Document	*n*	*%*	*RI*
Basics			
Presentation	11	85%	4.36
Concept paper	8	62%	4.36
Financials			
Historical			
Non-audited financial statements	11	85%	4.64
Audited financial statements	10	77%	4.70
Budget (historical)	10	77%	4.50
Balance sheet	9	69%	4.89
Annual reports	7	54%	4.86
Tax returns	4	31%	4.50
Forecast			
Budget (forecast)	11	85%	4.73
Business plan	11	85%	4.64
Financial projections	11	85%	4.55
Proposed exit strategy	5	38%	5.00
Industry			
List of main market players	9	69%	4.11
Industry Analysis	8	62%	4.63
SWOT Analysis	8	62%	4.13
Third-party Market Analysis	5	38%	4.20
Management			
Personal documents (CV, motivation letter, references)	9	69%	4.34
Product			
Description of value proposition	7	54%	4.57
Forecast turnover	6	46%	4.50
Pursued price	3	23%	5.00

Document (cont.)	*n*	*%*	*RI*
Customer			
Estimated no. of existing clients	9	69%	4.78
Estimated no. of future clients	8	62%	4.63
Description of target customer	6	46%	4.33
Customer testimonial	3	23%	4.67
Operations			
Distribution strategy	6	46%	4.67
List of suppliers	4	31%	4.50
HR planning	3	23%	4.67
Competition			
List of main competitors	11	85%	4.18
Description of competitive advantage	9	69%	4.56
List of substitute goods	4	31%	4.00
Social impact			
Description of impact	10	77%	4.70
Description of target stakeholder	9	69%	4.22
Description of impact measurement	7	54%	4.71
Industry-sector-specific certifications	5	38%	4.60
Legal			
Legally binding contracts	11	85%	4.45
Litigation	5	38%	4.80
Various			
Personal meeting and / or field trips	9	69%	4.88

Table 7: Required documents for proposal evaluation in Impact Investing

Source: Author's elaboration

Impact Investors sometimes request tax returns from social ventures in Latin America to ensure they do not finance illegal operations. *"Often, there is the problem that the ventures' business partners are not legal, (...) they do not pay any taxes. So we have to make sure this does not boomerang: if the venture has any problems, this must not rebound on us, as we provide the funding. There is a big risk involved. (...) there is nobody enforcing the laws and taxes there"* (N.N., Interview, 2013e).

Other than in the previous screening phase, most Impact Investors now request a business plan for an in-depth evaluation (cf. Section 4.2.1.1). By way of forecast financial data, Impact Investors often ask for a provisional budget and for financial projections. Stating the anticipated revenues and expenditures and giving estimates of future financial performance generate awareness among the social venture's managerial staff and are an indicator for the realism of the entrepreneur and his team. Impact Investors attach importance to these documents, because financial planning forces the entrepreneur to translate his main objectives into specific targets. Planning also serves as a feedback and warning tool: if strong deviations from the projections occur, the entrepreneur should still be able to make adjustments. Last but not least, some Impact Investors expect the social venture to outline the planned exit strategy and relevant procedure. Impact Investors gear their investments towards the intended exit; at the same time, the social venture is given support to establish the structures and financial resources required to avoid the danger of mission drift – the social venture has to continue generating both financial returns and social impact after Impact Investors withdraw funds. *"We want to have a financial and social return, when exiting. For us, it is important for the company to establish social guidelines in its own operating model. Because that assures us – once the company grows and is sold at some point in time, (...) – that the company will maintain its core potential for social impact"* (N.N., Interview, 2013b). However, not every Impact Investor requires documents on a proposed exit, implying that the exit is not yet a key issue for Impact Investors at the deal evaluation stage. This in turn reflects the fact that Impact Investing markets still need to develop for a conventional exit scenario, such as an IPO. *"We strive for IPOs, but the Brazilian market is not ready yet"* (N.N., Interview, 2013b).

Impact Investors request documents on the industry. Most frequently, Impact Investors ask social ventures to provide a list of market players, in order to verify which companies actively participate or are indirectly involved in the social venture's industry. The main market players do not necessarily compete directly with the social venture, but they can be decisive for market forces, e.g. by setting industrial standards affecting the social venture. In this context, Impact Investors are likely to take the next step and request an analysis of the industry, namely a

detailed examination of the conditions observed. Ultimately, an industry analysis of external factors forces the social venture to obtain detailed market knowledge and estimate its own operational success. Impact Investors may even require an additional SWOT analysis to evaluate the strengths, weaknesses, opportunities and threats ensuing for the social venture from the industry. Social ventures also need to identify internal factors crucial for achieving their objectives, and some Impact Investors also consult analyses done by third parties, e.g. financial or research institutions, in order to get an objective perspective.

The entrepreneur and the social venture's management team are also required to submit their personal documents, such as CV, motivation letter and references. *"(...) we do a lot of the due diligence on the entrepreneur itself and require the respective documents. (...) we try to talk to them, we try to understand them, we want to see if they are the right people to make the idea successful"* (N.N., Interview, 2013a). Impact Investors want to find out about the skills, experience and education of the persons behind the social venture, and investigate whether they appear qualified to successfully achieve the dual objectives. Impact Investors also verify the motivation of the persons behind the social venture by asking for a letter of motivation, in which the entrepreneur explains his interest and why he wants to establish the social venture and benefit the community. Finally, Impact Investors review recommendations before taking an investment decision – reference letters provide a third party's opinion on the entrepreneur.

In their evaluation, Impact Investors also consider documents related to the product. Before providing funds to social ventures, Impact Investors ask for specifications of the product's value proposition, so that they can determine the value the product creates for the customer and evaluate whether the product will be able to satisfy the community's prevailing needs. The entrepreneur and the management team have to explain why customers should buy the social venture's product. Ultimately, since the value proposition is part of the social venture's strategy, the costs and benefits of the product have to be described and analysed. Social ventures are also required to provide an estimate of turnover and forecast how many products will be sold during the financial period. An Impact Investor's objective in this respect is to determine the social venture's profitability. Contrary to expectations, only a few Impact Investors are interested in the price of the product which the social venture aims to obtain on the market; Impact Investors however focus on "value for money" (cf. Section 4.2.2.4).

Impact Investors regard the size of the market as important. Documents describing the customer base and the specific product being offered indicate how many customers the social venture will be able to reach. *"We require documents that describe the market and show*

where there is an identified business opportunity" (N.N., Interview, 2013f). It may also bring further risks to the entrepreneur's notice: for instance, under certain circumstances customers might acquire an influence over the social venture by building up bargaining power, forcing the social venture to observe a certain price level and thus increasing its dependency on that particular group (Porter, 2008, p. 83f.). Situations such as this reduce the social venture's ability to operate profitably and to generate social impact. To avoid this happening, Impact Investors request a list of the future potential customers, outlining the entrepreneur's target group and indicating the product's market potential. Some Impact Investors also require a more detailed description of the target customers, so that they can estimate whether the product offered will fit the customer base and whether there is any risk of dependency. Finally, some Impact Investors request a client testimonial about usage of the product, in order to assess whether the product will satisfy the customers' needs, namely enable them to improve their living conditions. Ultimately, the Impact Investor's objective is to determine the product's acceptance on the market, and whether it will improve the customers' prevailing circumstances without becoming dependent on a particular target group. Thus Impact Investors explore the social venture's potential to scale up – the prerequisite for greater profitability and wider social impact.

Some Impact Investors are interested in the social venture's actual operations and request related documents. Social ventures are usually asked in this context to describe their distribution strategy, namely how the products are transferred to the customer, because the product distribution strategy influences the company's market entrance and penetration (Porter, 2008, p. 82). This description is the basis for any future support from the Impact Investor because it also outlines scope for improvement. Social ventures are sometimes expected to list their suppliers, who in certain circumstances can exert an influence over the business and make the social venture more dependent, decreasing profitability and raising prices (Porter, 2008, 82f.) and thus reducing the social venture's ability to generate social impact. Finally, some Impact Investors are interested in the social venture's HR planning. Regarded as an asset, HR is a determinant for achieving a competitive advantage (Mills, Platts & Bourne, 2003, p. 977ff.), because the social venture must dispose over the knowledge required for achieving the dual objectives of financial returns and social impact. Impact Investors require documents on HR planning, to ensure that the social venture has the required skills and personnel and does not build up expensive surpluses in manpower.

Competition is another important dimension crucial to Impact Investors. Social ventures have to submit a list of main competitors, namely companies that directly compete with the social

venture and provide similar products on the market. Growing numbers of competitors in the industry intensify rivalry, especially if the products supplied are similar. However, increasing rivalry in turn leads to price discounts, service improvements and other reactions, ultimately limiting profitability (Porter, 2008, p. 85). To be prepared for such situations, Impact Investors ask for a description of the social venture's competitive advantage: the company must possess or acquire resources and attributes that ensure its survival in competitive markets and form a sound basis for generating financial returns and social impact. Closely related in this context are substitutes, namely goods that fulfil the same functions by different means and have the potential to displace the social venture's product. As the threat of substitution increases, profitability decreases (Porter, 2008, p. 84f.), hampering the social venture's ability to achieve its dual objective. Impact Investors therefore request a list of the substitute goods available on the market, in order to determine the associated risk.

Impact Investors also ask for documents relating to social impact. Most frequently, funds require a description specifying the social impact the social venture generates. Some Impact Investors also request documents depicting the target stakeholder, in order to clarify who is to benefit from the social impact. Notably, the overall community addressed is regarded as the stakeholder of a social venture. Interestingly though, documents on how to measure the social impact – the third aspect of the social impact dimension – are less frequently requested. *"We ask for social impact, we want to understand how they measure the social impact and get information on how they evaluate and control the social impact"* (N.N., Interview, 2013c). Effective impact measurement is essential: outlining, describing and communicating the social impact that is generated is critical for social ventures – otherwise the beneficiaries and society as a whole are given no clear idea of their value. "[Impact measurement] *is the only thing on paper that guarantees that* [social ventures] *are achieving social change and have a social mission"* (N.N., Interview, 2013e). Measuring social impact is therefore vital for monitoring performance and assessing whether the social venture has been successful in achieving the dual objectives being aimed for, and it is also a way of overseeing that social ventures actually pursue their social mission. If only the obvious financial return is clear but the social impact is unknown, the possible exit price for the Impact Investor will be lower. Consequently, measuring social impact can actually contribute towards the financial return which Impact Investors can obtain at the point of exit. Nonetheless, since impact measurement is complex and depends very much on specific circumstances, and since no broadly established standardized procedure exists, the majority of Impact Investors are wary of the actual measurement process. "*For impact measurement there is a lot of potential, and we have to get it right. Oth-*

erwise we will not be able to show the market, stakeholders, investors and society as a whole, what is the difference between what we're doing and normal, more traditional investments" (N.N., Interview, 2013f). Some Impact Investors rely on industry-sector-specific certifications to evaluate the social impact, but social ventures need a certain size and organisational structures and financial power to obtain such a certification. *"What we would like to ask – but we cannot, because* [social ventures] *do not have the structures – would be for some kind of certification (...)"* (N.N., Interview, 2013e).

Impact Investors generally request documents relating to legal issues. Social ventures are likely to be asked to disclose their legally binding contracts, because Impact Investors assess the risk associated with any obligations of the social venture that might become a liability in future. *"We want to make sure that the venture is legally well constituted, running and operating within the law"* (N.N., Interview, 2013a). Otherwise, in the event of any illegal activities rendering the social venture liable to pay compensation to a contractual partner, the investment would be doomed. Some Impact Investors even ask for documents on ongoing litigation, because the social venture's potential liability has to be evaluated and contingencies may have to be made and the investment from the Impact Investor may have to be collateralised.

Finally, besides requesting documents giving facts and figures, some Impact Investors regard personal meetings and field trips as important: *"For us it is very important to meet the entrepreneur in person"* (N.N., Interview, 2013b). Impact Investors want to get their own impression, actually experience the social venture in the field, and talk to the related persons to obtain feedback. *"(...) we want to talk to* [the people] *and want to get to know them. We want them to explain us their business – for that there is no real documentation involved"* (N.N., Interview, 2013f).

4.2.2.2 Entrepreneur and Management Team

As the requested documents already indicate, individuals running a social venture ideally need to have certain skills and characteristics. The personal features considered by Impact Investors who are evaluating eligible entrepreneurs and management teams are very varied and reflect the value proposition underlying the concept of Impact Investing. *"(...) we look into the whole character of an entrepreneur, including his commitment to social impact"* (N.N., Interview, 2013b).

Ultimately, social entrepreneurs must strive for the dual objectives of Impact Investing. *"We look for persons that are especially committed to the idea of benefiting the community. They must be driven by the idea of being successful in terms of financial and social return. We want*

someone that we know we can work with (...)" (N.N., Interview, 2013a). Impact Investors therefore search for individuals who will satisfy this requirement and do not adjust their attitude opportunely as situations change. *"We want to partner with a person who is committed to an idea and is not prone to change it when the environment changes"* (N.N., Interview, 2013a).

Ideally, social entrepreneurs in Impact Investing are characterized by high integrity, acting and behaving consistently with their values and principals; honesty, being truthful, fair and sincere; social values, reflected in their attitude and how available resources are dedicated to society; responsiveness, listening to others and considering new suggestions; and long-term orientation, namely persistence and targeting future goals. "*They must be willing to sacrifice a short-term return for the development of a long-term dream"* (N.N., Interview, 2013f). This criterion is also included in the social venture's long-term impact strategy (cf. Section 4.2.2.3). The above-mentioned attributes apply to a personal level and ensure that the Impact Investor cooperates with individuals who will reliably work towards achieving both financial returns and social impact.

Social entrepreneurs must also demonstrate high motivation and trustworthiness; *"(...) the person must have enough business experience to understand the market and the industry the venture is playing in"* (N.N., Interview, 2013a). Interestingly, education is regarded as less important in this context. Besides working hard and devoting themselves to the task in hand, social entrepreneurs must have risk awareness – Impact Investors search for persons who know the right time to take the right kind of risk. Moreover, individuals must be able to take well-informed, effective and timely decisions under pressure, perceive the implications, and tolerate their outcome even if they imply negative consequences. Individuals must explain their vision for generating financial returns and social impact, and be able to achieve their objectives efficiently in terms of costs in relation to proceeds.

The two final criteria with the highest relative importance are the individual's reputation within the community, and sincerity. Impact Investors search for social entrepreneurs who have a high standing in the community, since this increases acceptance and the easiness of building up a market: *"(...) the entrepreneur* [should be] *from the community and working within the community (...)"* (N.N., Interview, 2013e). Interestingly, Impact Investors do not expect the social entrepreneur to be a reference in the field. Sincerity is also considered most important: individuals should speak openly and honestly about their thoughts, vision and intention. Contrary to expectations, only a few Impact investors consider the entrepreneurs' creativity, emo-

tional involvement, open-minded personality and willingness to share ideas as selection criteria.

Criteria	*n*	*%*	*RI*
Integrity	11	85%	5.00
Honesty	10	77%	4.90
Social values	10	77%	4.70
Responsiveness	10	77%	4.50
Long-term orientation	10	77%	4.40
Motivation	9	69%	5.00
Trustworthiness	9	69%	5.00
Business experience	9	69%	4.78
Hard working	9	69%	4.78
Risk awareness	9	69%	4.78
Decision-makinger	9	69%	4.44
Visionary	9	69%	4.33
Efficiency	9	69%	4.22
Achievement oriented	8	62%	4.63
Ability to take criticism	8	62%	4.50
Ability to create a market	8	62%	4.38
Reputation within community	7	54%	5.00
Sincerity	7	54%	5.00
Capacity to sustain intense effort	7	54%	4.86
Devoted to social impact	7	54%	4.86
Compatibility with investors	7	54%	4.71
Financial knowledge	7	54%	4.57
Passion	7	54%	4.57

Criteria (cont.)	*n*	*%*	*RI*
Achievements to date	6	46%	4.50
Communication skills	6	46%	4.33
Flexibility in reacting to change	6	46%	4.33
Management relation	6	46%	4.17
Personal network	6	46%	4.00
Market familiarity	5	38%	4.80
Efficacy	5	38%	4.60
Energy level	5	38%	4.60
Good listener	5	38%	4.60
Emotional involvement	5	38%	4.40
Open-minded	5	38%	4.40
Willingness to share ideas	5	38%	4.40
Realism	5	38%	3.80
Cleverness	4	31%	4.50
Complementary skills	4	31%	4.25
Convincingness	4	31%	4.25
Education	4	31%	4.25
Political involvement	4	31%	3.00
Creativity	3	23%	4.33
Regarded as reference	3	23%	4.33
Opposed to mission-drift	3	23%	4.00
Personal sympathy	2	15%	4.00
Positive aggression	2	15%	4.00
Role within the fund management team and potential development	1	8%	5.00

Table 8: Evaluation criteria – Entrepreneur and Management Team

Source: Author's elaboration

Notably, Impact Investors search for social entrepreneurs who have the maturity to accept an investor and are aware of the implications of investors participating, since Impact Investments involve change: *"The entrepreneur has to be open for partners, but often they do not know what it's like to have a partner. They are very close to their business and it is not necessarily*

easy to get a group of people that have not created the idea of the business, but are coming in, investing and becoming co-owners. Therefore they will be changing things – an entrepreneur really has to be very comfortable with that process of going through such an investment" (N.N., Interview, 2013b).

In view of the long period over which Impact Investors normally actively engage with their social ventures, entrepreneurs who will collaborate well with the fund's employees are selected. *"We also look at their compatibility with our own team and with ourselves, (...) because the relationship is going to last for up to eight years"* (N.N., Interview, 2013b). Hence personal relationships are crucial; personal sympathy on the other hand is not.

Summarising, the social entrepreneur and management team are a crucial dimension in the evaluation phase of Impact Investing. The number of responses regarding the social entrepreneur and the management team that was received in this study indicates that this dimension is the most crucial. Although various criteria applied in Impact Investing are similar to those encountered in traditional Venture Capital, this newer concept relies heavily on personal relationships whilst adding further criteria that relate to social issues, reflecting the importance of the dual objectives. In line with the personal character of the Impact Investing industry, the selection criteria applied are assessed at an individual level – the personal basis for successful and constructive collaboration is considered crucial. In contrast, financial knowledge, achievements to date and communication skills are not considered so relevant.

4.2.2.3 Social Venture

The social ventures Impact Investors select for an investment have to fulfil certain criteria during the evaluation phase. These criteria again reflect the dual objectives of Impact Investing.

The Impact Investors who were interviewed emphasized social impact. *"We look to see if the companies have the commitment to create a positive social impact, beyond the financial returns. That has to be identifiable in the company's core strategy"* (N.N., Interview, 2013b). *"We expect every company to significantly improve the quality of life for the community and the people served"* (N.N., Interview, 2013a).

Criteria	*n*	*%*	*RI*

Criteria (cont.)	*n*	*%*	*RI*

Ability to generate revenues	10	77%	4.90
Profitability	9	69%	5.00
Competitive advantage	9	69%	4.78
Scalability of business model	9	69%	4.78
Long-term impact strategy	9	69%	4.56
Return potential	8	62%	5.00
Innovative capability	8	62%	4.63
Strategic alignment towards social impact	7	54%	4.71
Cost structure	7	54%	4.57
Replication of business model	6	46%	4.67
Social transformation	6	46%	4.67
Efficient utilisation of resources	6	46%	4.33
Corporate governance	5	38%	4.80
Market development	5	38%	4.60
Disclosure of business model	5	38%	4.40
First mover advantage	4	31%	4.25
Obedience of industry-sector-specific standards	3	23%	5.00
Transferability of concept	3	23%	4.66
Involvement of community	3	23%	4.33
Venture regarded as example of success	3	23%	4.33
Focus on benefitting customers	2	15%	5.00
Support new enterprise creation in other communities	2	15%	5.00
Disruptive business model	2	15%	4.50
Knowledge transfer	2	15%	4.50
Positive perception of venture within the community	2	15%	4.50
Proportion of female employees	2	15%	4.00

Table 9: Evaluation criteria – Social Venture

Source: Author's elaboration

In the online questionnaire, most Impact Investors also indicated that they especially evaluate a social venture's ability to generate revenues, and its profitability and cost structure – criteria typically applied in traditional Venture Capital. Evaluation criteria related to social issues, such as social transformation – i.e. society's development by stimulating change in collective consciousness and refinement of consensus –, benefiting the customer and involving the community in the social venture's processes, are less frequently assessed. However, the fact that social ventures by definition have to be strategically aligned towards social impact suggests that Impact Investors can be expected to focus on promising, performance-oriented social ventures that will also benefit the community – in Impact Investing, financial returns and social impact ultimately correlate.

Impact Investors prefer investing in social ventures that are actually in the field and in direct contact with customers, to make sure that their investment generates more than just financial returns: *"We prefer investing in companies that are going to the consumer or the final user, not a business merely involved in a product's resale or distribution. Because in that way we can ensure that we have a positive impact on the community"* (N.N., Interview, 2013a). To

ensure the social venture will actually be able to achieve the dual objectives in this context, Impact Investors analyse the social venture's resources and its capacity to achieve a competitive advantage in the market (cf. Section 4.2.2.1). *"We always look at the competitive advantage of the organisation and try to gauge if such an advantage can be achieved within a market"* (N.N., Interview, 2013c).

Impact Investors evaluate the business model, and the three aspects of scalability, replicability and disruption are scrutinized in particular. First, great importance is attached to a social venture's business model being scalable – as the company grows, both financial returns and social impact should likewise increase. Second, the business model should be replicable, i.e. specifically reproducible in different markets and regions, where it can be copied and duplicated: *"We* [know about] *various very interesting business models that are replicable in different parts of the world. The objective should be to shift the acquired knowledge across markets and regions and to make these models grow in other parts of the world"* (N.N., Interview, 2013c). Nonetheless, replicability remains subordinate in priority to scalability: *"The replication of the business model is not a criterion for us – the mandate in our interest is to serve the local market that we find big enough to fund"* (N.N., Interview, 2013f). Impact Investors tend to see themselves as pioneers working on a concept that can be further exploited on a broader basis, and they therefore look out for markets with growth potential for scaling up the social venture's business model (cf. Section 4.2.2.5). Nonetheless, although the basic concept should be transferable and Impact Investors will allow it to be adapted to new markets and regions, they are opposed to the unique business model the social venture has developed being disclosed to third parties. Similarly, Impact Investors rarely appreciate knowledge transfer for setting up new enterprises in other regions. Third, the business model does not initially have to be disruptive, i.e. fundamentally different, refining or optimising business practices such that they cause market upheaval, and individual models may show similarity without being highly sophisticated in themselves. However, once the market becomes saturated, the business model will need to be disruptive*: "If the market is not big enough to accommodate another product, the business model has to be scalable, replicable and disruptive, in order to expand the market (...)"* (N.N., Interview, 2013a). Thus as competition on the market increases, the business models of social ventures have to become more sophisticated in order to secure a competitive advantage. *"(...) most companies that we invest in have a proper business model – they do not specifically play alone on the market, but with a business model that helps to build up a competitive advantage"* (N.N., Interview, 2013a).

Ascertaining whether the dual objectives are sustainable in the long-term calls for evaluation of a social venture's impact strategy: an Impact Investor considers how a social venture can achieve social impact and efficiently utilise the available resources to benefit society, while still generating financial returns. Developing an impact strategy involves drafting plans and scheduling milestones, which serve as a framework for achieving the pre-defined objectives in the long-term. The impact strategy connects the creation of social impact to the activities generating financial return, and shows the ultimate correlation between the two. In order to secure social impact in the long-term, some Impact Investors also consider how to integrate the community into the social venture's processes, so that the local population is involved in both producing and consuming the social venture's products; thus the product becomes an expression of the long-term strategy (cf. Section 4.2.2.4). Ideally, an impact strategy includes measurement of the social impact generated for testing assumptions, making adjustments and supporting the decision-making process – similar to traditional business metrics. Last but not least, an impact strategy describes the purpose and outlines the mission and vision of a social venture to the stakeholders, ultimately reflecting the company's value and giving the Impact Investor guidance for a future potential exit.

In line with the concept of social entrepreneurship, Impact Investors assess the innovative capacity of social ventures. The company must not necessarily be innovative in terms of new developments, but rather in applying existing solutions in new areas. *"We as a fund foster innovation in the new space of companies that are looking to improve the lives of millions of people. The kind of innovation that we are looking for is not the traditional Silicon Valley innovation and it is not necessarily own technology. Often we find low-tech solutions that are applied to new problems. We look into ways of providing different kinds of services: sometimes it is knowledge transfer from another industry or country"* (N.N., Interview, 2013b). Hence, small innovations and the transfer of knowledge rather than a disruptive business model help to build and change a market.

Numerous Impact Investors in Latin America also evaluate the corporate governance of social ventures – an aspect deemed crucial in view of the informal business prevailing in the region. This involves the Impact Investor assessing the mechanisms, practices and processes used by the social venture for managing and controlling its actions, in order to avoid the risk of financing any illegal business operations. Informal business is not necessarily of a criminal nature – it simply does not follow the recognized legal framework. *"Very important to us and also very delicate, is the aspect of corporate governance within the company. There is a lot of informal business going on in Latin America – these businesses do also grow, but their cor-*

porate governance is not professionalised. This is a huge problem, as the business grows and new money is provided. This has to be addressed from early on, otherwise no capital will be attracted" (N.N., Interview, 2013b). Impact Investors also evaluate social ventures' corporate governance in the manner adopted in Venture Capital, in order to reduce and overcome the problems thematized in the Principal-Agent Theory (cf. Section 2.5).

Some Impact Investors verify whether the social venture is a first-mover on the respective market. First-movers have the advantage of being less exposed to competition and are able to focus on their development in terms of recognition, customer loyalty, and product and process optimisation. Operating on a market which the social venture is first to enter increases the chances of success, since the company is able to strengthen its position, gathering expertise, knowledge and resources before competitors try to share in the opportunity. Hence first-movers will try to increase the market-entry barriers to prevent other companies entering the market (cf. Section 4.2.2.5) *"Most of the organisations, which had success in the past, were first-movers. We had difficulties with solutions that were entering an old market trying to get a share"* (N.N., Interview, 2013c).

In summary, the social venture dimension comprises a number of the most important criteria which Impact Investors consider during the deal evaluation phase. Some of the criteria reviewed are similar to those in Venture Capital, such as the focus on the social venture's ability to generate revenues and its profitability and cost structure. Impact Investing then adds a social component, reflecting the philanthropic influence. Various criteria, such as strategy, innovative capacity or corporate governance, are adapted towards achieving the dual objectives. In particular, the business model of social ventures is expected to be scalable, replicable and disruptive, because Impact Investors aim for maximum reach even prior to their investment. However, although Impact Investors' stated aim is to ultimately benefit a wider community, they may opt to have a successful business model treated as a trade secret, only to be replicated by the social venture wanting to develop further market opportunities. This poses a discrepancy: Impact Investing emerged as an alternative financing form for social entrepreneurship and also incorporates the social objectives of Philanthropy; since its declared aim is to achieve as wide a social impact as possible, Impact Investors would be expected to appreciate knowledge transfer and concept sharing, and to welcome their business models being successfully implemented by others for the well-being of communities elsewhere. Ultimately, this finding suggests that in Impact Investing's social venture dimension, the main focus still remains on the benefits of competitive advantage – a feature characteristic of Venture Capital – rather than on the social objectives found in Philanthropy.

4.2.2.4 Product

Besides assessing the social entrepreneur and the social venture, Impact Investors also evaluate the product provided before deciding whether to make an investment – the product has to meet certain criteria, again reflecting the dual objectives in Impact Investing.

In Impact Investing the product offered is the most important tool for generating social impact, so the most frequent aspect Impact Investors consider is whether the product will provide a solution to prevailing social problems in practice. *"The product has to be an effective solution and it has to really tackle the problem"* (N.N., Interview, 2013c). Thus the product is expected to generate social impact, i.e. to have a positive effect on the wellbeing of the individual consumer and of the community generally. *"We assess whether (...) the product increases the quality of life for the people receiving the product or service"* (N.N., Interview, 2013a). It is noted that social impact can be intentional or unintentional: *"Sometimes companies are founded with the intention to impact; sometimes they are created with the potential for impact. But often these companies do not even know themselves that they could generate impact. So we look at the companies from very early onwards"* (N.N., Interview, 2013b). A social venture's impact can by all means be on a significant scale to society, without necessarily affecting people directly. Moreover, the social impact actually generated by the product is difficult to measure, and although various approaches have been developed it is still a matter of on-going discussion. *"We use the* [Name X] *impact model, which is a model that evaluates effect at five levels: purpose, activity, output, outcome and social impact. (...) we go to each level and try to evaluate mature wellness, social well-being, physical wellness, security and freedom"* (N.N., Interview, 2013c). The first two levels describe the reason for the social venture and the action it takes. Whilst output refers to the direct results of the social venture's activities, e.g. number of new employees, outcome describes the changes people experience as a result of the social venture's actions, e.g. higher income. Measuring outcome is relatively straightforward – one reason why measurement often ends at this level and impact is communicated in terms of outcome rather than being accurately measured. However, if the impact is to be measured, the outcome has to be adjusted by effects that would have happened anyway and that are beyond the social venture's control, e.g. inflation. It can be difficult to fully capture these effects. Impact Investors also evaluate whether the social venture's product provides a sustainable solution to a prevailing problem. The product is expected to provide a lasting impact for the individual beneficiaries and the overall community, while simultaneously generating financial returns – again, both these aims are correlated and the social impact is connected to the social venture's commercial operations. Consumers are included in the social

venture's processes, ideally both producing and using the products offered – thus the product's sustainability is directly linked to the company's long-term impact strategy (cf. Section 4.2.2.3).

Criteria	*n*	*%*	*RI*
Social impact	13	100%	4.54
Sustainable solution	9	69%	4.67
Quality	8	62%	4.63
Affordable price	8	62%	4.50
Innovation	8	62%	4.25
Regulation	7	54%	4.29
Unique value proposition	6	46%	4.17

Criteria (cont.)	*n*	*%*	*RI*
Customer awareness	5	38%	4.80
Customer reach	5	38%	4.80
Empowerment of customer	5	38%	4.80
Social need addressed	5	38%	4.80
Branding	3	23%	4.00
Potential for product bundling	1	8%	(4.00)

Table 10: Evaluation criteria – Product

Source: Author's elaboration

Impact Investors expect the product provided by the social venture to be of good quality. The product must be to a standard which satisfies consumers' expectations and needs. It must conform to requirements, be suitable for the intended usage, and compete with comparable products. It must also realise social impact and be reliable in terms of providing a sustainable solution to the identified problem. Moreover, the product has to be within the financial means of the respective customers: incurring financial risks or difficulties on consumers will be an obstacle to consumption. Impact Investors therefore need to ensure that the consumer is offered an appealing and suitable solution by providing a product at an affordable price. They also pay attention to the price of the product for image reasons – financial risks, questionable financing options and high prices are considered unethical, and Impact Investors are anxious not to give the impression that they are taking advantage of consumers, especially if the low-income population is being served. To achieve affordability however – i.e. low prices in keeping with the financial means of the low-income population – costs per unit have to be kept down. The social venture therefore needs to have a scalable business model and an appropriate cost structure, must use its resources efficiently (cf. Section 4.2.2.3), and must operate on a market with sufficient growth potential (cf. Section 4.2.2.5). Impact Investors also focus on "value for money", and cutting costs per unit is not necessarily straightforward: *"(...) cutting costs without affecting the level of quality is possible. But people are just being inefficient. They do not do things right and keep costs too high. (...)* [The objective is to] *cut costs per unit, while keeping the level of quality constant"* (N.N., Interview, 2013d).

Impact Investors expect the product to be innovative only to a certain degree – the product does not need to be a completely new development and just simple innovations can contribute towards satisfying prevailing needs. Applying existing solutions to new areas can likewise create social impact, but – as in the social venture dimension – Impact Investors frequently fail to consider transferring knowledge or sharing ideas in order to achieve this (cf. Section 4.2.2.3).

Impact Investors pay attention to the product's unique value proposition, i.e. a clear indication of the product's ability to make a unique contribution towards sustainably solving a problem. *"The solution has to deliver a social impact and a unique value proposition to the target group we are trying to serve"* (N.N., Interview, 2013f). The product offered on the market should be distinct from competing solutions and competitors should not be able to copy its beneficial value. *"The product has to be unique and has to be difficult to copy"* (N.N., Interview, 2013f). Nonetheless, it should be noted that the product is developed on the basis of an existing value proposition, rather than the other way round: social entrepreneurs identify market opportunities, look across industries to identify adoptable solutions, know customers' requirements and offer products creating value both for customers (social impact) and for investors (financial returns). Impact Investors search for *"(...) entrepreneurs who try to create a company in order to solve a problem, and not ones who have found a solution and then try to find a problem to solve"* (N.N., Interview, 2013f).

The empowerment of customers is a further criterion in the product dimension. As suggested by Santos (2012), the product empowers customers to contribute towards solving a problem, reducing their dependency while increasing their own wellbeing. Ideally, the specific product offered by a social venture with the support of an Impact Investor will enable individuals to improve their own personal circumstances. Ultimately, the community can thus alleviate or solve a prevailing problem itself – the Impact Investor can devote his attention and support to other social ventures that tackle different problems elsewhere. Surprisingly, it emerged in this study that Impact Investors tend to only infrequently consider this criterion.

In summary, most of the criteria Impact Investors apply in the product dimension are clearly distinct from those applied in traditional Venture Capital – social impact in particular is of utmost importance: the product must have some positive effect on the individual consumer and on the overall community. Moreover, Impact Investors expect a sustainable solution to a prevailing problem, and at the same time consumers are directly integrated into the social venture's product-related processes. Other criteria applied by Impact Investors, such as the

"value for money" aspect, are more in line with traditional Venture Capital, although specific considerations such as the affordability of the product are for social reasons. Finally, deliberations on the product's unique value proposition again reflect the approach taken in traditional Venture Capital.

4.2.2.5 External Factors

Besides the internal aspects of a social venture, there are further crucial external factors determining the success of the company that have to be evaluated by Impact Investors prior to an investment. *"We consider all the typical external environmental factors that may influence the success of the venture"* (N.N., Interview, 2013c).

The two most crucial external criteria Impact Investors review are the size of the market and market growth. *"We especially assess the market size and the growth potential of the market"* (N.N., Interview, 2013a). First, Impact Investors regard the size of the market, i.e. the number of potential consumers within the community; second, they consider market growth, i.e. the potential future increase in demand for the product offered. The two main questions Impact Investors raise in this context are: *"What are new markets that we can enter, as well as how can the current market share be increased?"* (N.N., Interview, 2013b).

The first of these questions relates to the criterion of competitive advantage. Impact Investors regard market competition as a key factor, although funds participating in this study outlined differing attitudes towards the acceptable intensity of competition. Some Impact Investors search for unattended markets with low competition: *"We want to see if there is still no one solving the identified problem in a better way or who already dominates the market"* (N.N., Interview, 2013f). In such circumstances, the social venture is in a relatively comfortable situation to achieve a competitive advantage (cf. Section 4.2.2.1). In contrast, if the market is characterized by high competition, other factors will determine the success of a social venture, such as the size of the investment (cf. Section 4.2.2.6) and the social venture's innovative capacity (cf. Section 4.2.2.3): *"If the market is too competitive, we do not enter. High competition means for us larger investments, in order to create market awareness – unless the social venture does not have an extremely innovative solution"* (N.N., Interview, 2013c). However, there are Impact Investors who appreciate competitive markets: *"By having more competition coming into the industry, we get validation that there is a profit to be made there. (...) Competition forces a venture to improve its business model, in order to better service the market and to increase efficiency. So we are open to competition, we just want the business model* [cf. Section 4.2.2.3] *we are investing in to be a very different one, one that has a suc-*

cessful formula" (N.N., Interview, 2013a). Generally speaking, Impact Investors accept competition up to the level at which social ventures are able to participate in the market and still achieve a competitive advantage – various factors determine the social venture's ability to differentiate itself, in order to cope with the competition on the market.

Criteria	*n*	*%*	*RI*
Market growth	12	92%	4.58
Market size	11	85%	4.73
Competitive advantage achievable	9	69%	4.67
Market entry barriers	9	69%	4.56
Legal system	9	69%	4.44
Access to financial market	8	62%	4.88
Price level on market	8	62%	4.63
Regulation	8	62%	4.63
Differentiation	7	54%	4.71
Intensity of competition	7	54%	4.43
Prevailing social need	6	46%	5.00
Market exit barriers	6	46%	4.67

Criteria (cont.)	*n*	*%*	*RI*
Gross margin potential	6	46%	4.50
Market players	6	46%	4.50
Relative power of customers	6	46%	4.50
Relative power of suppliers	5	38%	4.80
Political Influence	5	38%	4.60
Market resistant to economic cycles	5	38%	4.40
Private sector orientation of market	4	31%	4.50
Substitute products available	4	31%	4.25
Potential for consolidation	4	31%	4.00
Intensity of technology	3	23%	4.67
Public opinion	3	23%	4.33
Market supervision	2	15%	5.00

Table 11: Evaluation criteria – External Factors

Source: Author's elaboration

The first question also brings up the further criterion of market entry barriers. These include: economies of scale; capital requirements; access to distribution channels; product differentiation; regulation; price levels on the market; customer loyalty; customer switching costs. Market entry barriers pose an advantage which established social ventures operating on the market as first-movers (cf. Section 4.2.2.3) have over new entrants (Porter, 2008, p. 81). Once successfully doing business, new market players increase a market's available production capacity, while at the same time downsizing market shares; as a result, prices come under pressure and social ventures have to become more cost-efficient – two factors which will call for further investment if a social venture is to remain competitive. During the evaluation phase, Impact Investors therefore need to carefully assess the obstacles which a social venture has to overcome before it can operate successfully on the market, but which on the other hand can subsequently protect the enterprise if it is added to their portfolio – and thus by all means contribute to the attractiveness of an investment: *"We look at market entry barriers. We want*

(...) nobody to be able to jump into the market and provide the same solution within a short time period" (N.N., Interview, 2013f).

In comparison, few Impact Investors consider market exit barriers. Certain obstacles – such as highly specialised assets, customer loyalty and write-offs – prevent social ventures from exiting a market if the company has failed to capture the required market share or has missed performance targets. The risk of entering a market with high exit barriers – implying that the social venture might be forced to continue operating and competing on the market – is usually considered by Impact Investors who are planning larger investments. This circumstance in effect turns an exit barrier into an entry barrier: companies are unlikely to be encouraged to enter the market, if prospects for an exit are poor.

The second question of increasing the market share relates to the scalability of the business model (cf. Section 4.2.2.3). *"We look at the market and whether there is the ability for growth, so scalability"* (N.N., Interview, 2013b). Impact Investors consider scalability as important, since increasing market shares benefits more people in the community, strengthens the company's market position, and offers greater potential for cutting costs per unit (cf. Section 4.2.2.4).

Impact Investors also consider the prevailing legal system – namely the reliability of the law, the consistency of legal decisions and the enforcement of regulations – because aspects regulating business practices and policies as well as rights and obligations are relevant in decision-making. In the case of informal business – i.e. activities that are not necessarily of a criminal nature but are not in line with the prescribed legal framework – which may find it easier to enter new markets, Impact Investors also assess a social venture's corporate governance in order to avoid financing illegal operations (cf. Section 4.2.2.3).

As part of their evaluation of an investment, Impact Investors when assessing external factors also consider access to the financial market and the potential for consolidation. This is because easy access improves the prospects for an exit. Impact Investors can aim to exit for example by means of consolidation or an IPO: *"In terms of the financial market, we would like to see the potential for an IPO and consolidation for exits"* (N.N., Interview, 2013b). Such exits enable social entrepreneurs to further expand their business and generate value on a larger scale, while Impact Investors achieve returns.

In addition, Impact Investors expect a social need to prevail on the market; there must be the potential to generate gross margins; the other parties participating on the market are consid-

ered; and the political influence on the market is assessed. Some of the Impact Investors taking part in the study indicated that they require the market to be resistant to economic cycles – an aspect relating to portfolio diversification (cf. Section 4.2.2.6). Only a few appear to assess the relative power of consumers, suppliers and the availability of substitutive products – as is reflected in the documents required for an evaluation (cf. Section 4.2.2.1).

Summarising, the external factors Impact investors consider are not substantially different from those in traditional Venture Capital, although there is a social component. Both concepts primarily focus on the size and growth of the market in order to ensure that the company will have a better chance of prosperous development. Impact Investors accept tough competition, provided the social venture is able to differentiate itself and achieve an advantage, but here – other than in Venture Capital – the competitive advantage is mainly for the sake of benefitting consumers. In this context market entry barriers are evaluated, either to protect existing portfolio companies or to assess the difficulty of entering a new market. Market growth is linked to the scalability of the business – as the market grows, Impact Investors want to see the social venture increase its consumer base, social impact and ultimately financial returns.

4.2.2.6 Deal Features

Besides the above-mentioned evaluation criteria, Impact Investors also consider certain criteria relating to the deal itself – the characteristics of the deal reflect the aspects mentioned so far.

Impact Investors necessarily consider the risk inherent in an investment, but the term itself is manifold and has various meanings; thus it is understood differently in different fields. In the context of Impact Investing, risk is defined as the possibility of results failing to meet expectations. The financial return might differ from that anticipated, the Impact Investor might lose part or even all of its investment, and the positive social impact originally envisaged might not be achieved. Besides the general risks to which investors may be exposed, financial and social risks in Impact Investing in Latin America have multiple sources: *"(...) if the venture has any problems, this must not rebound on us, as we provide the funding. There is a big risk involved. (...) But we want to take the risks, in order to provoke social change. There is no legal structure to protect us and to enforce our rights"* (N.N., Interview, 2013e). In line with the basic assumption in finance that greater risk is compensated by higher returns, some Impact Investors are willing to assume bigger risks for the sake of greater potential for returns – which in Impact Investing must be financial and social. Impact Investors investing in Latin American demonstrate differing attitudes towards risk: while some are very conservative,

others deliberately assume more risk, hoping to achieve a higher financial return and provoke social change at the same time.

Criteria	*n*	*%*	*RI*
Risk	12	92%	4.67
Financial instrument	10	77%	4.70
Exit strategy - financial aspects	9	69%	4.78
Social guidelines	9	69%	4.78
Exit strategy - social aspects	8	62%	4.79
Management control	8	62%	4.50
Ownership	8	62%	4.50
Portfolio diversification	8	62%	4.50
Required financial resources	8	62%	4.25
Management compensation	7	54%	4.00
Personal trust	6	46%	4.67
Financial participation of founder	6	46%	4.50

Criteria (cont.)	*n*	*%*	*RI*
Legal obligations of venture	5	38%	4.80
Tax considerations	5	38%	4.20
Selection of board members	4	31%	4.75
Contingency financing	4	31%	4.50
Contractual partner	4	31%	4.50
Additional follow-up services	4	31%	4.25
Retention period	4	31%	4.25
Screening costs	3	23%	4.33
Performance fee for fund	2	15%	5.00
Potential for M&A	2	15%	4.50
Protection of (in-)tangible assets	2	15%	4.50

Table 12: Evaluation criteria – Deal Features

Source: Author's elaboration

Impact Investors regard the financial instrument involved in the investment. Impact Investing combines various financial instruments, depending on and reflecting the investor's portfolio target of balancing return expectations, risk appetite and impact goals (cf. Section 2.4.1). Generally speaking, Impact Investors deploy equity, debt-based financial instruments and various subcategories of these financial instruments.

Already during the evaluation phase, Impact Investors assess the potential for a successful exit – in Impact Investing, the exit is considered crucial (cf. Section 2.4.1). In general, exits in Impact Investing are expected to simultaneously generate financial returns and social impact. It is important for the social venture to have sufficient financial resources to continue its operations and for the social impact to persist despite the exit of an investor. *"The work done within an investment must continue, (...) the exit strategy has to ensure that the standards achieved are also provided in the future"* (N.N., Interview, 2013d). The concept of Impact Investing originated from Philanthropy and Venture Capital, and it reflects a different approach as regards the financial and social return of an exit; among Impact Investors however, priorities vary regarding the optimal balance between the dual objectives (cf. Section 2.4.3).

Finance-first investors seek to optimise the financial return while achieving a pre-defined floor for social impact. *"We focus on the exit opportunities: we have to be able to sell and monetize our shares"* (N.N., Interview, 2013f). Impact-first investors on the contrary optimise the social impact while achieving a pre-defined floor for financial returns. *"We are impact-first investors and pay attention to proving that our investments have had a significant social impact"* (N.N., Interview, 2013c). So if an Impact Investor exits an investment by selling the social venture to another investor, the social impact must continue and be developed further: *"Regarding the exit in terms of social returns, (...) whoever comes in to take our place, has to deploy the potential and take it to the next level"* (N.N., Interview, 2013a). Impact Investors moreover have a pre-defined time horizon (cf. Section 2.4.1): *"Regarding the exit, we consider the time: the exit should be in five to seven years' time"* (N.N., Interview, 2013c). In practice however, some investors *"(...) take ten to twelve years until an exit"* (N.N., Interview, 2013e).

Since an investment in an Impact Investing fund entails risks, Impact Investors diversify their portfolio to reduce the likelihood of losses. There are two possibilities for diversification. Impact Investors can invest in numerous social ventures in different sectors, thus imposing various restrictions *"regarding how much of our capital can be allocated to certain sector and companies"* (N.N., Interview, 2013a). The investor's risk attitude determines the number of portfolio companies and the variety of sectors represented – risk-averse investors diversify to a greater extent between these two dimensions than their risk-affine counterparts. However, not every Impact Investor diversifies the portfolio: *"The portfolio of* [Name Y] *is not really diversified. We are specialised within one sector – that builds up specialist knowledge but also exposes our portfolio to certain risks inherent within the sector"* (N.N., Interview, 2013d). These investors merely diversify their portfolio by investing in several different social ventures, but more risk-averse Impact Investors will still diversify across sectors: *"If we have already invested in one sector and then identify another good investment opportunity, then we lose the deal"* (N.N., Interview, 2013f). Besides reducing risk, Impact Investors also have another motivation to diversify their portfolio: *"(...) it is interesting to have different types of organisations, in order to showcase them"* (N.N., Interview, 2013c).

Impact Investors ensure moreover that the deal establishes certain social guidelines or a codex and that policies and principles govern the social venture's procedures. *"For us, it is important for the company to establish social guidelines in its own operating model. Because that assures us – once the company grows and is sold at some point in time, or if there is an*

IPO – that the company will maintain its core potential for social impact" (N.N., Interview, 2013b).

Impact Investors also differentiate between ownership and management control – a distinction of utmost importance in Latin America, where social ventures are often family-owned. Although Impact Investors do not own the social venture, they provide non-financial support and take an active management role (cf. Section 2.4.1). Impact Investors *"(...) exercise other shareholder rights so that they can participate in the happenings of the company. (...) Impact Investors give technical assistance, management advice and financial support, but do not own the company. This approach is highly appreciated by company owners, because it means they can retain proprietorship of their company"* (N.N., Interview, 2013g). These aspects are important to Impact Investors, because the issues described by the Principal-Agent Theory are addressed and administered (cf. Section 2.5).

There are other criteria in the deal dimension which Impact Investors also evaluate. First, the financial resources required, i.e. the amount of capital the social venture needs. The amount has to correspond to the deal size that is being sought by the Impact Investor and that is in line with the fund's risk considerations. Second, management compensation, i.e. the remuneration the social venture's managers receive which might be composed of several components, such as a regular salary, bonuses, shares in the business, or non-pecuniary benefits. Third, financial participation by the social venture's founder: this aspect relates to ownership and management control, and Impact Investors might have varying attitudes towards the founder's financial involvement. Impact Investors also assess whether the persons standing behind the social venture are trustworthy – but this aspect cannot be evaluated by applying fixed criteria, because the personal relationship and the entrepreneur's personality are decisive (cf. Section 4.2.2.2).

Summarising, Impact Investors and Venture Capitalists consider similar evaluation criteria in the deal dimension. For one thing, both concepts regard risk as being crucial, but the former concept considers risk in both financial and social terms – independent of the individual investor's risk appetite. Second, both approaches already regard the exit as an important criterion during the evaluation phase and demand a successful exit. But whilst traditional Venture Capital merely considers an exit in terms of financial returns, Impact Investing considers positive social impact as an additional component. There is no distinction between the two concepts in terms of portfolio diversification – funds in both approaches normally diversify their portfolios over various investments and sectors, although differences might occur due to individual risk attitudes. Impact Investing is clearly differentiable in terms of ownership and man-

agement control: although both concepts provide support and supervise the management, Impact Investors do not seek to actually own the company, a highly appreciated fact in Latin America where social ventures are often family-owned. Finally, Impact Investing makes use of a broader variety of financial instruments and ensures that in its processes the social venture establishes social guidelines so as to ensure that the social impact continues after exit.

4.2.2.7 Interim Findings

Taking a holistic view of the five dimensions of evaluation criteria reviewed above, it becomes evident that social aspects are predominant and heavily influence an investment decision in Impact Investing.

The characteristics and personal attributes of entrepreneurs and management teams are of utmost importance – an expression of the personal nature of the Impact Investing industry. Impact Investors search for integer, honest and trustworthy persons with outstanding social values to cooperate with – hard facts such as education and previous business experience are secondary. Ultimately, Venture Capitalists also consider personal factors when making an investment, but Impact Investors add a social component and search for social entrepreneurs willing to work towards achieving social impact besides financial returns.

Although not so crucial, the social venture is also a decisive dimension. In one respect, Impact Investing and Venture Capital are barely distinct here: both concepts assess social ventures primarily according to their profitability and competitive advantage as well as their return potential and ability to generate revenues. However, in Impact Investing these traditional criteria are regarded in a new context, namely the social impact of the venture. Thus social ventures have to feature social aspects and meet special related criteria, such as a long-term impact strategy or strategic alignment towards social impact. Impact Investing also takes a different approach towards innovation: the social venture is expected to be innovative in that it applies known technology and maybe even external knowledge to new markets. In order to achieve the dual objectives targeted in Impact Investing, a social venture’s business model also has to be scalable so that it can persist in competitive markets and replicable so that it can develop as wide a reach as possible.

Impact Investing and traditional Venture Capital are similar as regards the fact that the product must offer a unique value proposition to the consumer. But Impact Investing again adds a social component: the product must be good value for money and affordable for the community served, and it must provide a sustainable solution in the sense that a prevailing problem is alleviated or solved in the long-term.

Impact Investors and Venture Capitalists likewise both consider market size and market growth as crucial evaluation criteria; in Impact Investing however, a social component is again evident. One of the main reasons why Impact Investors want their social ventures to achieve a competitive advantage on the market is in order to benefit consumers and create a social impact, and provided that succeeds they are generally willing to accept tough competition.

Thus in the deal dimension, similar criteria are applied in Impact Investing and Venture Capital for evaluating proposals – after all, neither concept aims to make losses. A feature of Impact Investing however is that the social component is omnipresent, and some Impact Investors even emphasize the importance of establishing social guidelines to ensure the continuance of the social impact after exit. Impact Investing in Latin America also differentiates between ownership and management control, respecting the fact that many social ventures there are family-owned and Impact Investors involved in the region take other steps to safeguard their influence.

4.3 Declined Proposals

Finally, Impact Investors participating in the study were asked to indicate further procedure in the event of a proposal failing to meet their screening or evaluation criteria and a social venture not being funded.

The attitude taken by Impact Investors towards proposals that do not meet their investment criteria is ambiguous, and depends on various factors such as the fund's resources, the number of proposals in the fund's pipeline at the time, the point reached in the selection process, the social venture's stage of development and its accumulated requirements, and its potential to create social impact.

Some Impact Investors simply disregard proposals that do not meet their screening or evaluation criteria and do not take any further action. *"If a proposal does not fit our criteria, we simply turn it down and move on to the next one. We have enough proposals"* (N.N., Interview, 2013g). Funds meeting with big demand for financing might simply focus their resources on searching for the best investment opportunity. Others might not have the capacity to further occupy themselves with proposals that have poor prospects; these proposals are then not even referred to another fund – Impact Investors indirectly filter out poor proposals for each other. Impact Investors are not bent on making an investment at all costs – instead, they select promising social ventures for their portfolio and focus on qualitatively outstanding social ventures that have high potential for social impact. *"(...) if we do not find an appropri-*

ate entrepreneur who fully fits our criteria, then we prefer to wait and continue managing our portfolio" (N.N., Interview, 2013c). Nonetheless, some Impact Investors inform the social venture about the reasons for its rejection, thus giving the proposal a chance to make improvements. *"When a project is not for us, we communicate the facts and reject the project"* (N.N., Interview, 2013a).

Factor	*n*	*%*	*RI*
Disregard proposal	8	62%	4.50
Refer proposal to another fund	8	62%	4.40
Provide non-financial support to make proposal meet criteria	6	46%	4.66
Provide financial support to make proposal meet criteria	1	8%	4.00
Re-interpret financial criteria	1	8%	4.00

Table 13: Declined proposals
Source: Author's elaboration

If an Impact Investor happens to evaluate a promising proposal that does not align with the fund or fails to fulfil the fund's specific investment criteria, the proposal can be redirected to another Impact Investor, giving the social venture the chance to obtain financing from well-matched sources. *"If a project is presented to us and it is not within our investment scope, or it does not meet our deal criteria, we tell the entrepreneur that we do not have the right profile for that kind of project. Then we recommend the entrepreneur to look for something different and redirect him to another fund"* (N.N., Interview, 2013a).

Sometimes Impact Investors will evaluate and decline a proposal initially, but will offer to provide the social venture with non-financial unpaid support to meet the applied criteria, if its proposal looks promising and has high potential for generating social impact. *"With such companies, we start working with them and provide them support and advice, in order to make them fit our criteria"* (N.N., Interview, 2013b). So some Impact Investors may spend *"two to three weeks, maybe even two months"* (N.N., Interview, 2013b) with a social venture and provide uncompensated non-financial support – even before signing any formal document – if the proposal has the potential to become a success in terms of generating impact. Giving this kind of assistance largely depends on the stage reached in the evaluation process, the social impact which may potentially be generated, and the social venture's overall requirements.

Impact Investing as a concept envisages social ventures with the potential to simultaneously meet the dual objectives of financial returns and social impact. As a logical consequence, Impact Investors interpret the process of successfully identifying proposals that meet their in-

vestment criteria as confirmation of their business model. *"If we didn't find any deals that are in line with our fund's criteria, then it wouldn't make sense to continue the fund. (...) that would prove that the concept is not right"* (N.N., Interview, 2013f).

5 Impact Investing is Venture Capital with a Philanthropic Twist[10]

An established process model on how Impact Investors select their portfolio companies does not exist. For Venture Capital, the first widely recognized selection process model was proposed by Tyebjee and Bruno (1984). These authors broke down the selection process into four general stages: deal origination; proposal screening; proposal evaluation; and deal structuring. This model also serves as a basis for selection procedure in Impact Investing, although the weighting of the individual selection criteria at each stage may vary, depending on the specific circumstances of the respective Impact Investing fund.

When originating deals for investment and assessing social ventures in Latin America, Impact Investors appear to apply approaches, methods and processes which are comparable to those applied in Venture Capital. Nonetheless, the influence of Philanthropy is evident at the same time, because in Impact Investing the social objectives of that particular concept are equally important. It was observed in the study that in effect, the Venture Capital selection process model as proposed by Tyebjee and Bruno (1984) is adapted in Latin America for application to social ventures, and that a social component is added.

Impact Investors use passive deal origination sources similar to those observed in traditional Venture Capital, i.e. referrals are received. However, the opposite can also occur: through their own network, Impact Investors are introduced to promising social ventures. It should be realised though that there are aspects specific to the Latin American market: since the Impact Investing industry there is small in size and still developing, personal contacts and access to networks are of utmost importance. The most promising deals are those Impact Investors find through their own network, which is why they prefer to proactively search for investment opportunities. Market players meet on a regular basis at conferences and other industry events for networking and to identify suitable investment opportunities. Parties without extensive contacts or access to the relevant circles make use of alternative networks, such as the Internet or external match-making platforms, or call in intermediaries. Impact Investors also occasionally use more unconventional methods for originating deals, such as calling for bids, business incubation, accelerator programs or actually setting up new social ventures.

[10] (N.N., Interview, 2013g)

Similar to procedure in traditional Venture Capital, Impact Investors require various documents after contact has been established with a social venture. However, since social ventures in Latin America are not necessarily able to submit complex proposals, Impact Investors there are rather more flexible and might merely ask for basic documentation from potential candidates. In some cases, Impact Investors even help to draft complex documentation, e.g. business plans, if the company shows high potential for achieving the dual objectives being targeted.

The screening phase in Impact Investing is likewise similar to that in traditional Venture Capital – the same criteria are assessed for aspects relating to e.g. portfolio structure or risk considerations. However, Impact Investors expect the social venture's ability to simultaneously generate social impact on a wide scale to already be evident during the screening phase.

In the evaluation phase, Impact Investors assessing social ventures in Latin America again appear to follow the same approach as is taken in traditional Venture Capital: the same dimensions are considered – i.e. entrepreneur and management, social venture, product, external factors, and deal features – but the criteria of each dimension are adjusted to reflect Impact Investing's dual objectives. Notably, Impact Investors considering an investment in Latin America seem to focus in particular on the first dimension: the individuals behind the company and their attitudes and personalities are considered crucial if the dual objectives are to be achieved, if information asymmetry is to be avoided and if mission drift is to be prevented: Impact Investors highly appreciate moral values, whilst educational and business background – although important – is regarded as being secondary.

The social venture itself is expected to show the ability to generate revenues and be profitable. This is not necessarily self-evident, because Impact Investing emerged as an alternative financing model for social entrepreneurship and incorporates the social objectives of Philanthropy. At the same time, in Impact Investing a social venture is expected to have a scalable business model, so that as the company grows, both its financial returns and its social impact will also increase. Impact Investors expect the product to have some kind of positive effect on the individual consumer and on the wider community, by being affordable and providing a sustainable solution to a prevailing problem. This is surprisingly to the extent that as early as during the screening and evaluation phases – i.e. prior to investment – Impact Investors expect the social venture under review to show potential for an outcome (i.e. social impact) that cannot be planned in absolute terms and can only be assessed in retrospect.

The external factors Impact Investors consider are again similar to those reviewed in tradi-

tional Venture Capital, but again a social component is added. Both concepts focus on market size and market growth to ensure prosperous development of the company, but Impact Investors see market growth in relation to the scalability of the business, to which they attach special importance. Similarly, Impact Investors prefer their social venture to achieve a competitive advantage on the market, but likewise for the sake of benefitting the community and not merely for capital gain as in Venture Capital.

Impact Investors diversify their portfolios as regards the investments made and the sectors represented, paying heed not only to financial risks – as in Venture Capital – but also to social risks, whereby individual risk attitudes and the sectors focussed on are bound to vary. It is peculiar to Impact Investors that they do not seek to actually own the company, and even during the evaluation phase, exit is an important criterion – not however solely with a view to making capital gains, as in Venture Capital, but also with regard to both the profitable continuation of the venture and the sustainability of its social impact.

Finally, it is common to both Venture Capital and Impact Investing that if a proposal does not meet the criteria applied during the selection process, the proposal may simply be disregarded. A special feature observed in Impact Investing however is that provided the venture has potential, the Impact Investor may give non-financial support to help it meet the requirements, or refer it to another fund in its network, both at no charge.

Thus the observations made in the study reflect the influence of both Venture Capital and Philanthropy in Impact Investing in Latin America: adding a social component to already established selection criteria suggests that Impact Investing in the region is indeed *"Venture Capital with a philanthropic twist"* (N.N., Interview, 2013g). Nonetheless, these findings still entail a degree of uncertainty and can by no means be regarded as hypotheses. Below, propositions are therefore put forward on Impact Investing in Latin America, which are offered as a basis for discussion and further research.

The first proposition follows from the findings summarized above:

Proposition 1: *The selection process for Impact Investing in Latin America generally follows the model proposed by Tyebjee and Bruno (1984); the four phases may be refined on an individual basis.*

Especially in the small-scale industry found in Latin America, personal relationships and intensive networking characterize Impact Investing as a developing investment approach. In terms of deal origination, the Impact Investing space in Latin America is underdeveloped,

because the mainly small and family-owned businesses are difficult to identify as potential investments and lack the prerequisites for proactively offering proposals. Personal contacts and networks bring Impact Investors and social ventures together – in the sense of Tyebjee and Bruno (1984), by both passive and active means:

Proposition 2: *The deal origination phase in Impact Investing on the Latin American market heavily depends on personal contacts and networking. Impact Investors actively search for deals <u>inside</u> their network; social ventures proactively contact Impact Investors <u>through</u> their network. Parties without access to the relevant circles apply unconventional deal origination methods, resort to alternative networks or call in intermediaries.*

Social entrepreneurs in Latin America often have difficulty approaching Impact Investors appropriately. However, the success of an Impact Investing fund – and thus ultimately the achievement of the dual objectives in Impact Investing – is contingent on its engagement in promising social ventures:

Proposition 3: *In terms of deal origination in Latin America, Impact Investors prefer searching actively for attractive and promising social ventures, because active deal origination is more rewarding.*

After initial contact has been established between an Impact Investor and a social venture, the actual selection process begins. During the screening phase, as in Venture Capital, Impact Investors have to first narrow down the numerous proposals that come to the fund's attention. The pre-selected proposals are subsequently reviewed in depth during the evaluation phase:

Proposition 4: *The deal screening and evaluation phases in Impact Investing are similar to Venture Capital – the same selection dimensions are taken into account. In Impact Investing however, the criteria applied in each dimension are adapted to reflect the industry's dual objectives – sector-specific social criteria play a decisive role in the screening and evaluation of proposals.*

The adjustment made to the criteria applied in each dimension, adding a social component, reflects an Impact Investor's dual objectives. Although these objectives differ from those being pursued in Venture Capital, both concepts attach huge importance to the persons actually involved in achieving them:

Proposition 5: *The profitability of a social venture and the social impact of its product hinge on the attitude, values and commitment of the social entrepreneur and his management team. The social entrepreneur is thus the most important dimension for assessing investment pro-*

posals.

Impact Investors investing in social ventures in Latin America aim to create value for the wider community. However, social ventures in Latin America do not always have the prerequisites to qualify for an investment. Creating value for society in some sectors in Latin America therefore calls for unconventional measures, without which Impact Investors might not find appropriate investment opportunities:

Proposition 6: *Impact Investors give social ventures in Latin America non-financial support to meet their selection criteria, provided each company clearly has the potential to achieve the dual objectives being targeted.*

The concept of Impact Investing adopts approaches, methods and processes that are characteristic of Venture Capital, while simultaneously incorporating additional criteria that reflect the social objectives of Philanthropy. Hence the ultimate generalising proposition:

Proposition 7: *Impact Investing as a developing discipline correlates to Venture Capital with a philanthropic twist. Depending on the specific approach taken, the characteristics of either pillar are emphasized.*

This final proposition states that the criteria applied during the selection process in Impact Investing are to a certain extent similar to those applied in Venture Capital: social ventures must be profitable and able to compete on the market. At the same time however, the selection criteria are geared towards the additional component incorporated in Impact Investing – namely, the social impact that a social venture is expected to generate for the wider community.

All these propositions need to be tested, in order to prove or refute them – ultimately this process will lead to tentative hypotheses, on which basis a new theory can then develop.

6 Limitations and Further Research

This paper has limitations, but nonetheless it brings up a number of issues worth further research.

6.1 Limitations

The first and most obvious limitation of the study is the sample size – regrettably, merely 13 out of 90 Impact Investors who were contacted responded to the online questionnaire; thus the response rate was only approx. 15%, eliminating statistical validity. Obviously the author, intending initially to conduct a sound statistical analysis, would have liked more participants

to respond. Since this was not the case, the study had to make a qualitative interpretation after combining the quantitative data obtained from the online questionnaire with the information provided in the interviews.

The methodology used in the paper is also has limitations in view of the shortcomings of the *Exploratory Sequential Design* which has been applied. For one thing, eight Impact Investors involved in social ventures in Latin America were interviewed; interviewing more Impact Investors would have increased the validity of the findings, thus providing a wider basis and giving greater substance to the qualitative research subsequently conducted. Second, the online questionnaire developed for the quantitative phase also had limitations, in that the author had to decide which data from the interviews to include, thus bringing subjectivity into the research. In addition, since the number of Impact Investors involved in social ventures in Latin America is limited, including the eight interview partners in the quantitative phase who had already provided data during the qualitative phase could be questioned. Finally, the selection criteria presented to the participants in the online questionnaire and the answers they chose to give in their response might also be subject to post-hoc rationalisation. The limitations of the study thus relate to subjective aspects.

6.2 Further Research

Inductive research was conducted in this study, aiming to explore the process of how Impact Investors select their portfolio companies in Latin America and to identify the criteria applied. Given the fact that to date there is no theory on Impact Investing in this respect, exploratory research was done to evaluate the specific observations made and to obtain broader generalisations. The focus of the paper is therefore limited to finding an answer to the research questions, and it does not look into other aspects. Since Impact Investing is a developing heterogeneous industry marked by great complexity and versatility, the findings made and the conclusions drawn may form a basis for further research into the manifold aspects yet to be investigated.

First, the paper does not distinguish between the different financing phases in a social venture's life cycle – although each financing phase plays a role in the extent to which the dual objectives in Impact Investment are achieved, and Impact Investors are therefore likely to apply different selection criteria depending on the stage reached in the enterprise's life cycle. Future research might investigate the selection criteria applied in the five dimensions identified, giving consideration to the different financing phases in a social venture's life cycle.

Second, the paper does not differentiate between the various approaches taken in Impact In-

vesting. The numerous criteria identified in this study are an expression of the heterogeneous nature of Impact Investing, which is influenced by Venture Capital and Philanthropy. Further research might investigate the role of the two approaches *Finance First* and *Impact First* in deal origination and their respective influence on the selection criteria applied in each of the dimensions identified.

Third, the paper does not consider other variables and their influence on the criteria applied during an Impact Investor's selection process. Consequently, this paper's research questions might be used as a basis for further investigations focussing on specific aspects of the Impact Investing fund, e.g. domicile; year of foundation; number of portfolio companies; asset under management (AuM); legal structure; impact focus; asset class; target sector; deal size; residency of the fund's social ventures in Latin America; and the required internal rate of return.

Fourth, future research might investigate the conditions and circumstances under which Impact Investors are motivated to provide non-financial support to potential portfolio companies that look promising and offer the prospect of achieving the dual objectives in Impact Investing.

Fifth, since this paper focussed on exploring the selection criteria that Impact Investors apply during screening and the evaluation process, participants of the online questionnaire were merely asked to select and rate the importance of the criteria which they apply when selecting a social venture in Latin America for an investment. This approach indeed provided an indication of the importance of the selection criteria applied – but further research might emphasize and elaborate on this aspect, by applying the *Conjoint Method* to measure preferences regarding those criteria, and to determine which combination of a limited number of criteria is most influential for the investment decision.

Another interesting research topic could be based on complementing the standard portfolio theory à la Markowitz with a social dimension. In this respect, Impact Investing is a mathematical optimisation problem, in which the balance between financial return and social impact has to be optimised under certain constraints. The rationale of allocating capital to Impact Investing when choosing a portfolio can be explained, and the theoretical foundation for doing so can be described, but if the social return dimension is added to the framework the main prerequisite for this research approach is the measurement of social impact.

Further research in general needs to aim at collecting, processing and disseminating data. Since Impact Investing is a young and developing industry, sufficient data for academic re-

search is barely available and needs to be collected in a timely process. A database for academic research on Impact Investing, such as for Venture Capital, will have to be established. Ideally, Impact Investors could report directly to such a database on a voluntary basis.

7 Conclusion

Although Impact Investing in Latin America is still only in its beginnings, the findings made in the study confirmed that in that region at least, portfolio company selection basically uses the selection criteria and follows the selection processes observed in Venture Capital. The vital distinction between the two concepts is to be found in the social component which Impact Investing adds, in order to achieve the declared purpose of that particular investment approach, namely social impact in addition to financial returns, rather than just capital gain.

Nonetheless, these findings must be seen against the background of the widespread hype currently surrounding Impact Investing in Latin America. The term Impact Investing is sometimes used loosely there as a catchphrase aimed at accessing funds more easily, and the Impact Investing approach is thought by some to be a way of instantly solving any problem prevalent in society. That of course is not the case. Impact Investing still faces numerous challenges. In view of its complexity it will take much longer for Impact Investing to become firmly established, and in Latin America the benefits are unlikely to become evident within the next few years. Once it does become established, parties merely riding the tide of the current hype will vanish from the scene, because achieving the dual objectives will obviously be beyond their scope.

Most importantly, if is to be widely acknowledged as a worthwhile and rewarding approach in its own right, the Impact Investing industry will have to find reliable, accurate, accountable and consistent methods for measuring the social impact that it achieves when actually addressing complex social problems in different sectors. The role of Impact Investing and the significance of the aspects distinguishing it from more conventional investment approaches will only be fully appreciated – by investors themselves in particular – if the social impact that is generated can be presented in absolute terms alongside the financial returns. This is a prerequisite if Impact Investing in Latin America is to develop to its full potential, attract suitable investors to the spectrum, increase efficiency to a satisfactory level, and ultimately reach more people at local level. Success stories also need to be prepared by Impact Investors for publicity purposes, to convey the essence of Impact Investing and attract the right market players. Academia can play an important role by doing further research, developing methods for measuring impact, and publishing material for the Impact Investing industry at large. To

this end, Impact Investors need to be encouraged to foster collaboration with research institutions and contribute towards financing studies that can make use of existing potential and available knowledge, aimed at developing models from which the Impact Investing industry can benefit in practice.

Ultimately, the future of Impact Investing as an independent concept will depend on measurement of its social impact and effective communication of its achievements. Otherwise the concept is doomed to being regarded in time as a creative initiative that is no more than a subcategory of another investment approach – namely Venture Capital – with a social component merely added to already established selection criteria and processes.

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Appendix

A.1 Interview Partner

The Interview partners were chosen according to their knowledge, experience and involvement in Impact Investing in Latin America. The following tables summarize their background, current occupation and contact details.

Important: *All interview partners expressly requested not to be named directly in connection with quotes made in the paper, but agreed to provide their personal details for reference purposes. In order to avoid allowing quotes to be attributed to specific persons, the tables are sorted chronologically, i.e. in the sequence the interviews were conducted. The lower-case letters used to distinguish the quotes have been chosen randomly and do not refer to the chronology of the interviews.*

Institution	**Deutsche Investitions- und Entwicklungsgesellschaft (DEG)**
Description	DEG has been financing private-sector investments in developing countries since 1962. By promoting private sector development, DEG contributes to the creation of jobs and income and to better living conditions in the partner countries.
Interviewee	Yves Ehlert, M.Sc.
Work Position	DEG Regional Manager Mercosur
Contact	KfW Bankengruppe Representações Ltda. Rua Verbo Divino, 1488 – 3. Andar CEP 04719-002 São Paulo São Paulo – Brazil Phone: + 55 (11) 5187 5170 Fax: + 55 (11) 5180 4575 email: yves.ehlert@deginvest.de www.deginvest.de
Interview Date	10 May 2013 10:00 BRT
Duration	60 minutes

Institution	EcoEnterprises Fund
Description	EcoEnterprises Fund is a venture fund for nature, providing growth capital needed by small community-based sustainable companies to achieve scale, and generating lasting results that can help address the critical environmental and social challenges. EcoEnterprises Fund is launching its second fund.
Interviewee	Nathalie Prado, B.Sc.
Work Position	Investment Officer Latin America
Contact	EcoEnterprise Fund Centro Corporativo Nunziatura San José, Costa Rica Phone: + 506 2296 1501 Fax: + 506 2296 1451 email: nprado@ecoenterprisesfund.com Skype: natypv1 www.ecoenterprisesfund.com
Interview Date	10 May 2013 14:00 BRT
Duration	45 minutes

Institution	**IGNIA Partners LLC**
Description	IGNIA is a venture capital firm supporting the founding and expansion of high growth social enterprises that serve the base of the socio-economic pyramid in Mexico. IGNIA empowers entrepreneurship and generates social impact while creating attractive financial returns for its investors.
Interviewee	Ignacio Alvarez Lopez, B.Sc. MBA
Work Position	Principal
Contact	IGNIA Partners LLC Av. Ricardo Margáin 575 Parque Corporativo Santa Engracia San Pedro Garza García, N.L. México 66267 Phone: + 52 (81) 8000 7280 Fax: + 52 (81) 8000 7038 email: ial@ignia.com.mx Skype: nacho_alvarez1 www.ignia.com.mx
Interview Date	14 May 2013 11:00 BRT
Duration	30 minutes

Institution	Gera Venture Capital
Description	Gera Venture Capital is an investment company that focuses on education in Brazil. The company invests in high potential entrepreneurs with the dual objective of creating substantial impact in education while delivering attractive financial returns.
Interviewee	Guilherme Cintra
Work Position	Impact Investment Analyst
Contact	Gera Venture Capital Av. Epitácio Pessoa 1674 CEP 22411-071 Ipanema Rio de Janeiro – Brazil Phone: + 55 (21) 3202 8850 Fax: + 55 (21) 3202 8862 email: guilherme.cintra@geraventure.com.br Skype: guicintra1990 www.geraventure.com.br
Interview Date	14 May 2013 21:00 BRT
Duration	60 minutes

Institution	**VOX Capital**
Description	VOX Capital invests in innovative, high-potential businesses serving low-income clients. The activities contribute towards reducing poverty. VOX Capital injects capital and provides strategic advice and management support to leverage the financial results and social impact of the portfolio companies. Through its portfolio, VOX Capital aims to contribute to the creation of a Brazilian cluster of profitable, large-scale businesses with social impact, capable of attracting talent, innovation and capital. VOX Capital intends to help to improve the lives of millions of low-income individuals in Brazil.
Interviewee	Daniel Izzo
Work Position	Co-Founder and Partner
Contact	VOX Capital Av. Álvaro Anes, 46 CEP 05421-010 Pinheiros São Paulo – Brazil Phone: + 55 (11) 3034 4555 Cell: + 55 (11) 9659 5244 email: daniel@voxcapital.com.br Skype: daniel_izzo www.voxcapital.com.br
Interview Date	17 May 2013 09:00 BRT
Duration	30 minutes

Institution	**LGT Venture Philanthropy**
Description	LGT Venture Philanthropy (LGT-VP) is an impact investor supporting organisations with outstanding social and environmental impact. LGT-VP strives to increase the sustainable quality of life of less advantaged people by inspiring clients for active philanthropy, providing individualised philanthropic advice and investment implementation. The broad range of clients benefits from the experience, systems, processes and networks built by implementing the philanthropic engagement of the Princely Family of Liechtenstein/LGT Group.
Interviewee	Juan Carlos Moreno
Work Position	Investment Manager LatAm
Contact	LGT Venture Philanthropy Färberstrasse 6 8008 Zurich Switzerland Phone: + 41 (44) 256 8110 Fax: + 41 (44) 256 8111 email: juancarlos.moreno@lgtvp.com Skype: juan.moreno.lgtvp www.lgtvp.com
Interview Date	21 May 2013 17:00 BRT
Duration	60 minutes

Institution	Instituto de Cidadania Empresarial (ICE)
Description	ICE is active within the areas of strengthening local businesses and Social Finance. By strengthening local businesses, ICE supports communities that have the power to transform their own reality and promotes their development. ICE moreover focuses on Social Finance, given the potential for innovation and impact. ICE intends to work within numerous sectors, collaborating with global partners, investors and intermediaries, to identify new investment possibilities for social impact in Brazil. ICE promotes the improvement of related activities and disseminates what it has learned from other organisations, aiming at social impact. By sharing knowledge, ICE contributes to the country's development.
Interviewee	Luiza Camargo Nascimento
Work Position	Investment Project Manager
Contact	Instituto de Cidadania Empresarial (ICE) Rua Padre Manuel de Chaves, 78 CEP 01448-050 Jardims Europa São Paulo – Brazil Phone: + 55 (11) 3708-0491 email: luiza@ice.org.br www.ice.org.br
Interview Date	23 May 2013 09:30 BRT
Duration	60 minutes

Institution	**IFC Capital (FIRST Brazil Impact Investing Fund)**
Description	The project entails an IFC equity investment of up to $15 million in *Fundo de Investimentos Riqueza Social para Todos* (FIRST) Fund, (“FIRST” or the “Fund”), a 10-year closed-end Impact Investing fund that seeks to raise $125 million. The Fund will target growth companies that have the potential to provide products and services to the low-income population in Brazil. The capital aims to invest mainly in the North and Northeast of Brazil, in the sectors of education, health, housing, financial services. The Fund is managed by *FIRST Gestao de Investimentos*, a subsidiary of FIR Capital, a Brazilian venture capital fund manager established in 2001 that currently manages two funds in Brazil.
Interviewee	Maria Cavalcanti
Work Position	Managing Partner
Contact	FIRST Brazil Impact Investing Fund Praça Carlos Chagas 49 – 7. andar CEP 30170-020 Belo Horizonte Minas Gerais – Brazil Phone: + 55 (31) 3074 0020 Fax: + 55 (31) 3074 0015 email: maria.cavalcanti@firstimpact.com.br Skype: mcavalcanti.nyc www.ifc.org / www.fircapital.com
Interview Date	24 May 2013 11:00 BRT
Duration	40 minutes

A.2 Interview Guideline

The interviews conducted for the qualitative phase of the research followed the interview guideline given under. The conversations took place either in Skype or in personal meetings in São Paulo. All the interviews were conducted during May 2013. Except from one interview, English was the chosen language. For the interview in German, a translation of the interview guideline was used.

The interviews were of semi-structured type. The interview guideline was flexible for leading the conversation. Diversions from the guideline occasionally occurred to ensure the natural flow of the conversation and to generate a comfortable situation. Where appropriate, additional questions not mentioned in the interview guideline e.g. for clarification or for enquiring about further interesting aspects, were asked. Finally, the questions enumerated by lower-case letters were only asked, if the respective main question was not answered satisfactorily, i.e. prospective additional insights, or the conversation drifted in an undesirable direction.

Introduction

The paper researches the selection process and relevant selection criteria that Impact Investors apply when selecting their portfolio companies in Latin America. The object is to identify the origination of deals and to recognize the main selection criteria that Impact Investors consider when choosing a social venture in Latin America to invest in.

Given that different value propositions prevail in Impact Investing in comparison to Venture Capital, I aim to pinpoint distinctions between the variables which investors consider in these two approaches during the respective selection process.

Deal Origination

Please focus in the following on the origination of deal proposals that came the attention of your fund.

1. How do entrepreneurs bring deals to your attention?

a. Which communication channels encourage entrepreneurs to contact you?
b. Which innovative or unusual methods do entrepreneurs use to attract investors' attention?
c. What opportunities does the Internet provide?
d. Do industry events contribute towards deal origination?
e. What role does your own business network play?

2. How do you actively search for potential deals?

a. What are your possibilities for learning about potential deals?
b. How do you get to know interesting entrepreneurs?
c. Which parties do you contact when searching for potential deals?
d. Do your existing portfolio companies assist in your search for potential deals?
e. From which parties do you seek external advice?
f. What is your experience with searching for potential deals?

3. How do you proceed if you cannot identify an appropriate deal?

a. How important is a pre-defined social objective?
b. What is your experience with incubation?
c. Have you considered establishing a new social enterprise?

4. What documents are required from an entrepreneur after initial contact?

a. What documents do you expect from an entrepreneur proposing a deal?
b. How do you identify the entrepreneur's social mission?
c. How do you check the credibility and sustainability of an enterprise?
d. What reports do you review in order to forecast the success of a venture?
e. What formal documents do you request for further information and support?

Deal Screening and Evaluation

After you have received a deal proposal, the selection process begins. Please consider your fund's next steps in determining further procedure, aimed at obtaining a basis for an investment decision.

5. Which entrepreneurial features do you assess?

a. What kind of commitment do you expect from a social entrepreneur?
b. Is there a basic attitude that you consider crucial?
c. Do you assess the personality of the entrepreneur or management team?
d. Do any personal criteria have to be met before you decide to invest?
e. Which skills do you consider essential?
f. Does cooperation call for a specific approach?

6. Which of the social venture's factors do you consider?

a. What criteria must the venture meet in order to qualify for further support?
b. Which commercial aspects are considered relevant?
c. What specific features must the venture have?
d. What social effects do you expect from a venture?
e. How much scope for development is required?

7. What external factors play a role?

a. What market conditions do you consider important?
b. How much competition is acceptable?
c. What degree of familiarity is needed for entering a market?
d. What is your experience with economic cycles?

8. What are important deal characteristics?

a. What determines the attractiveness of a deal?
b. What aspects are relevant to the fund's portfolio?
c. What are your expectations with regard to an exit?

9. What kind of potential in Impact Investing do you consider crucial?

a. Which pre-defined objectives are relevant in Impact Investing?
b. What results must be achieved?
c. What attitude towards social issues is required?

A.3 Online Questionnaire

In line with the chosen methodology, the *Exploratory Sequential Design*, the insights gathered during the qualitative interviews were used to develop an online questionnaire which was set to the identified population of Impact Investors invested in Latin America. The chosen approach ensured the findings obtained from the conducted interviews were generalised during the quantitative phase. The questionnaire sent to the respective Impact Investors is attached in the following.

Introduction

Dear Participant

Thank you for taking 15 minutes of your time and for responding to this survey on Impact Investing. Your valuable contribution is highly appreciated, because your insights will support my thesis and give further substance to my research.

As a post-graduate student from the University of St.Gallen (HSG), Switzerland, and Fundacão Getúlio Vargas (FGV-EAESP) in São Paulo, Brazil, I am writing my master thesis about the selection process and criteria that Impact Investors apply for their portfolio companies in Latin America.

Important: *The questionnaire is anonymous. No backtracking is possible on the basis of the provided information. All the information provided will be treated strictly confidentially and with discretion.*

The first section contains general questions, while sections two and three refer to the selection criteria that are applied with regard to the origination and the evaluation of potential investment deals in Impact Investing.

The objective of the survey is to identify the origin of deals in Impact Investing, and to recognize the selection criteria that Impact Investors consider when choosing a social venture to invest in. The research focuses on Portfolio Companies domiciled in Latin America.

If you have any questions about this questionnaire, please do not hesitate to contact me by email (fabian.oppenheimer@student.unisg.ch), Skype (fabian.oppenheimer) or by phone (+55 11 98777 7929).

Best regards, Fabian Oppenheimer

General Information

- Name of fund (optional)
- Domicile of fund (country)
- Year of foundation (yyyy)
- Number of portfolio investments
- Total AuM (in million USD)
- Legal structure (please select applicable)
  - ○ *Foundation*
  - ○ *Non-profit organisation*
  - ○ *Donor-based Fund*
  - ○ *Trust*
  - ○ *Bank*
  - ○ *For Profit*
  - ○ *Other*
- Required deal size (optional; minimum, in thousand USD)
- Required IRR (optional, in percent)

Asset Class and Impact Focus

- Asset Class (multiple selection possible)

○ *Cash and Cash Alternatives*	○ *Private Equity*
○ *Commodities*	○ *Public Equity*
○ *Fixed Income*	○ *Real Assets*
○ *Hybrid Capital*	○ *Real Estate*
○ *Mezzanine debt*	○ *Venture Capital*
○ *Private Debt*	○ *Other*

- Impact Focus (multiple selection possible)

○ *Affordable Housing*	○ *Finance*	○ *Nutrition*
○ *Business Development*	○ *Forestation*	○ *Renewable Energy*
○ *Carbon Trading*	○ *Green Technology / Clean-Tech*	○ *Sustainable Agriculture*
○ *Community facilities*	○ *Health*	○ *Sustainable consumer goods*
○ *Education*	○ *Infrastructure*	○ *Sustainable Transportation*
○ *Employment generation*	○ *Labour Inclusion*	○ *Waste Management / Recycling*
○ *Environmental Commodities*	○ *Media / Entertainment*	○ *Water*
○ *Fair Trade*	○ *Natural Resources*	○ *Other*

Residency of Fund's Portfolio Companies

Please select the countries in Latin America where the fund invests (multiple selection possible)

○ *Argentina*
○ *Belize*
○ *Bolivia*
○ *Brazil*
○ *Chile*
○ *Columbia*
○ *Colombia*
○ *Costa Rica*
○ *Ecuador*
○ *El Salvador*
○ *French Guiana*
○ *Guatemala*
○ *Guyana*
○ *Honduras*
○ *Mexico*
○ *Nicaragua*
○ *Panama*
○ *Paraguay*
○ *Peru*
○ *Suriname*
○ *Uruguay*
○ *Venezuela*

Deal Origination

According to literature, the decision-making process for selecting portfolio companies is divided into four phases: Origination, Screening, Evaluation, and Structuring.

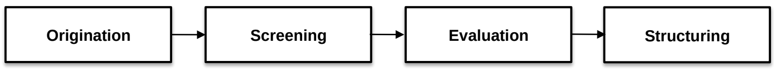


Figure 11: Decision Making Model in Venture Capital

Source: Author's Illustration based on Tyebjee and Bruno (1984); Sweeting (1991)

In the following, please focus on the origination of the deals your fund has learned about and has considered for an investment.

Unsolicited Proposals

Please select how the fund passively obtains unsolicited proposals from entrepreneurs. Please note: Proactive measures applied by the fund will be asked in the next question (multiple selection possible)

Miscellaneous
○ *Cold calls from Entrepreneur*
○ *Entrepreneurs are discouraged to send unsolicited proposals*
○ *Entrepreneurs do not contact fund*
○ *Entrepreneurs react on fund's call for bids*
○ *Entrepreneurs react on fund's public activities*
Networking
○ *Advisors contact the fund on behalf of entrepreneurs*
○ *Attendance at industry events*
○ *Entrepreneurs are redirected through an investor*

○ *Entrepreneurs are referred to fund by portfolio company*
○ *Fund engages in research with universities, research institutions, etc.*
○ *Other funds contact fund as potential co-investor*
Internet
○ *Entrepreneurs establish contact through fund's web-page*
○ *Entrepreneurs establish contact through third-parties' match-making platforms / programs*
○ *Entrepreneurs send unsolicited proposal by email*

Please rate the previously selected methods that entrepreneurs use to contact the fund, according to their respective importance.

	Very important	**Important**	**Neither important nor unimportant**	**Unimportant**	**Very unimportant**
Previously selected factor	○	○	○	○	○
…	○	○	○	○	○

Proactive search methods

Please select the methods that the fund proactively applies to receive proposals from entrepreneurs. (multiple selection possible)

Networking
○ *Participation in industry events*
○ *Business network of funds and investors*
○ *Existing portfolio companies*
○ *External advice from agencies or consultants*
○ *External matchmaking platforms*
Various
○ *Business incubation*
○ *Cold calls to entrepreneurs*
○ *Research*
○ *Foundation of new social venture*
○ *Government authorities*
○ *Submission of bid / tenders*
○ *Universities and research institutions*

Please rate the previously selected methods that the fund proactively applies to receive proposals from entrepreneurs, according to their respective importance.

	Very important	**Important**	**Neither important nor unimportant**	**Unimportant**	**Very unimportant**
Previously selected factor	○	○	○	○	○
…	○	○	○	○	○

Documents

Please select the documents the fund requests on which to base the investment decision (multiple selection possible).

Basics

○ *Presentation*

○ *Concept Paper*

Financials (Historical)

○ *Non-audited financial statements*

○ *Audited financial statements*

○ *Budget (historical)*

○ *Balance sheet*

○ *Annual reports*

○ *Tax returns*

Various

○ *Personal meeting and / or field trips*

Financials (Forecast)

○ *Budget (forecast)*

○ *Business plan*

○ *Financial projections*

○ *Proposed exit strategy*

Industry

○ *List of main market players*

○ *Industry Analysis*

○ *SWOT Analysis*

○ *Third-party Market Analysis*

Management

○ *Personal documents*

Product

○ *Description of value proposition*

○ *Forecast turnover*

○ *Pursued price*

Customer

○ *Estimated no. of existing clients*

○ *Estimated no. of future clients*

○ *Description of target customer*

○ *Customer testimonial*

Operations

○ *Distribution strategy*

○ *List of suppliers*

○ *HR planning*

Competition

○ *List of main competitors*

○ *Competitive advantage*

○ *List of substitute goods*

Legal

○ *Legally binding contracts*

○ *Litigation*

Social impact

○ *Description of generated impact*

○ *Description of target stakeholder*

○ *Description of impact measurement*

○ *Industry-sector-specific certifications*

Please rate the previously selected documents the fund requests, according to their respective importance

	Very important	**Important**	**Neither important nor unimportant**	**Unimportant**	**Very unimportant**
Previously selected factor	○	○	○	○	○
…	○	○	○	○	○

Deal Screening and Evaluation

After you have received a deal proposal, the screening and evaluation process begins. In literature, the following five dimensions are crucial for assessing a potential investment:

1. Entrepreneur and management team

2. Social Venture
3. Product
4. External Factors
5. Deal Features

Please consider your fund's next steps in determining further procedure, aimed at obtaining a basis for an investment decision.

Deal Evaluation

Please select the basic criteria that the fund applies first of all when assessing a proposal.

○ *Business Plan*
○ *Core competence*
○ *Geographic location*
○ *Impact focus*
○ *Investment size*
○ *Social relevance*
○ *Stage of financing*

Please rate the previously selected screening criteria, according to their respective importance.

	Very important	**Important**	**Neither important nor unimportant**	**Unimportant**	**Very unimportant**
Previously selected factor	○	○	○	○	○
…	○	○	○	○	○

Entrepreneur and management team

Please select the personal characteristics of an entrepreneur and the venture's management team that the fund assesses when considering a proposal for an investment.

○ *Ability to create a market*	○ *Efficiency*	○ *Passion*
○ *Ability to take criticism*	○ *Emotional involvement*	○ *Personal network*
○ *Achievement oriented*	○ *Energy level*	○ *Personal sympathy*
○ *Achievements-to-date*	○ *Financial knowledge*	○ *Political Engagement*
○ *Business experience*	○ *Flexibility to act to changes*	○ *Positive aggression*
○ *Capacity to sustain intense effort*	○ *Good listener*	○ *Realism*
○ *Cleverness*	○ *Hard working*	○ *Regarded as reference*
○ *Commitment to social impact*	○ *Honesty*	○ *Reputation within community*
○ *Communication skills*	○ *Integrity*	○ *Responsiveness*
○ *Compatibility with investors*	○ *Long-Term orientation*	○ *Risk awareness*

○ *Complementary skills*
○ *Convincingness*
○ *Creativity*
○ *Decision-making competence*
○ *Education*
○ *Efficacy*
○ *Management Relation*
○ *Market familiarity*
○ *Motivation*
○ *Open-minded*
○ *Opposed to mission-drift*
○ *Sincerity*
○ *Social values*
○ *Trustworthiness*
○ *Visionary*
○ *Willingness to share ideas*

Please rate the previously selected personal characteristics of an entrepreneur and the venture's management team that you assess when considering a proposal for an investment, according to their respective importance

	Very important	**Important**	**Neither important nor unimportant**	**Unimportant**	**Very unimportant**
Previously selected factor	○	○	○	○	○
…	○	○	○	○	○

Social Venture

Please select the relevant factors regarding the social venture that the fund assesses when considering a proposal for an investment.

○ *Ability to generate revenues*
○ *Competitive advantage*
○ *Corporate Governance*
○ *Cost Structure*
○ *Disclosure of business model*
○ *Disruptive business model*
○ *Efficient utilisation of resources*
○ *First Mover Advantage*
○ *Focus on benefitting customers*
○ *Innovative capability*
○ *Involvement of community*
○ *Knowledge transfer*
○ *Long-term impact strategy*
○ *Market development*
○ *Obedience of standards*
○ *Positive perception of venture*
○ *Profitability*
○ *Proportion of female employees*
○ *Replication of business model*
○ *Return potential*
○ *Scalability of business model*
○ *Social Transformation*
○ *Strategic alignment: social impact*
○ *Support new enterprise creation*
○ *Transferability of business model*
○ *Venture is example of success*

Please rate the previously selected factors regarding the social venture that you assess when considering a proposal for an investment, according to their respective importance.

	Very important	Important	Neither important nor unimportant	Unimportant	Very unimportant
Previously selected factor	○	○	○	○	○
…	○	○	○	○	○

Product

Please select the relevant factors regarding the product that the fund assesses when considering a proposal for an investment.

○ *Affordable price*	○ *Innovation*	○ *Social impact*
○ *Branding*	○ *Potential for product bundling*	○ *Social need addressed*
○ *Customer awareness*	○ *Quality*	○ *Sustainable solution*
○ *Customer reach*	○ *Regulation*	○ *Unique value proposition*
○ *Empowerment of customer*		

Please rate the previously selected factors regarding the product that your fund assesses when considering a proposal for an investment, according to their respective importance.

	Very important	Important	Neither important nor unimportant	Unimportant	Very unimportant
Previously selected factor	○	○	○	○	○
…	○	○	○	○	○

External Factors

Please select the external factors that the fund considers when assessing a social venture for a potential investment.

○ *Access to financial market*	○ *Market exit barriers*	○ *Prevailing social need*
○ *Competitive advantage achievable*	○ *Market growth*	○ *Price level on market*
○ *Differentiation*	○ *Market players*	○ *Private sector orientation of market*
○ *Gross margin potential*	○ *Market resistant to economic cycles*	○ *Public opinion*
○ *Intensity of competition*	○ *Market size*	○ *Regulation*
○ *Intensity of technology*	○ *Market supervision*	○ *Relative power of customers*
○ *Legal system*	○ *Political Influence*	○ *Relative power of suppliers*
○ *Market entry barriers*	○ *Potential for consolidation*	○ *Substitute products available*

Please rate the previously selected external factors your fund assesses when considering a proposal for an investment, according to their respective importance.

	Very important	Important	Neither important nor unimportant	Unimportant	Very unimportant
Previously selected factor	○	○	○	○	○
…	○	○	○	○	○

Deal Characteristics

Please select the characteristics associated with the deal that the fund considers relevant.

○ *Additional follow-up services*	○ *Legal obligations of venture*	○ *Protection of (in-)tangible assets*
○ *Contingency financing*	○ *Management compensation*	○ *Required financial resources*
○ *Contractual partner*	○ *Management control*	○ *Retention period*
○ *Exit strategy - financial aspects*	○ *Ownership*	○ *Risk*
○ *Exit strategy - social aspects*	○ *Performance fee for fund*	○ *Screening costs*
○ *Financial instrument*	○ *Personal trust*	○ *Selection of board members*
○ *Financial participation of founder*	○ *Portfolio diversification*	○ *Social guidelines*
○ *Additional follow-up services*	○ *Potential for M&A*	○ *Tax considerations*

Please rate the previously selected characteristics associated with the deal that the fund assesses when considering a proposal for an investment, according to their respective importance

	Very important	Important	Neither important nor unimportant	Unimportant	Very unimportant
Previously selected factor	○	○	○	○	○
…	○	○	○	○	○

Disregarded Proposals

Please select the steps the fund takes if a proposal fails to meet the applied investment criteria.

○ *Disregard identified investment opportunity*
○ *Fund has not yet encountered such a situation*
○ *Provide financial support to make investment opportunity meet criteria*
○ *Provide non-financial support to make investment opportunity meet criteria*
○ *Re-interpret financial criteria*

○ *Re-interpret social criteria*
○ *Refer to another fund*
○ *Other*

Please rate the previously selected steps the fund takes if a proposal fails to meet the applied investment criteria, accoring to their respective importance.

	Very important	**Important**	**Neither important nor unimportant**	**Unimportant**	**Very unimportant**
Previously selected factor	○	○	○	○	○
…	○	○	○	○	○

Conclusion

Thank you!

Dear Participant

You have reached the end of the questionnaire. You may close this window, your answers have been submitted.

Thank you for your valuable contribution, I highly appreciate your participation. Your insights will support my thesis and give further substance to my research.

If you have any questions about this questionnaire, please do not hesitate to contact me by email (fabian.oppenheimer@student.unisg.ch), Skype (fabian.oppenheimer) or by phone (+55 11 98777 7929).

Best regards,

Fabian Oppenheimer

A.4 Descriptive Data

The following section summarizes the data obtained from the first section of the questionnaire.

Table A1: Year of Foundation

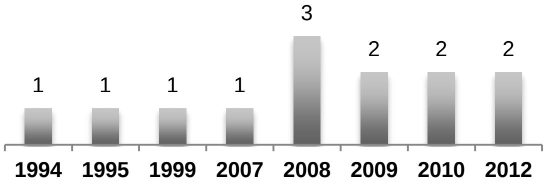


Table A2: Number of Portfolio Investments

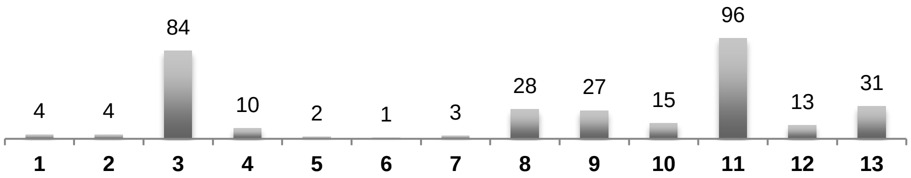


Table A3: Total Asset under Management (AuM) (in million USD)

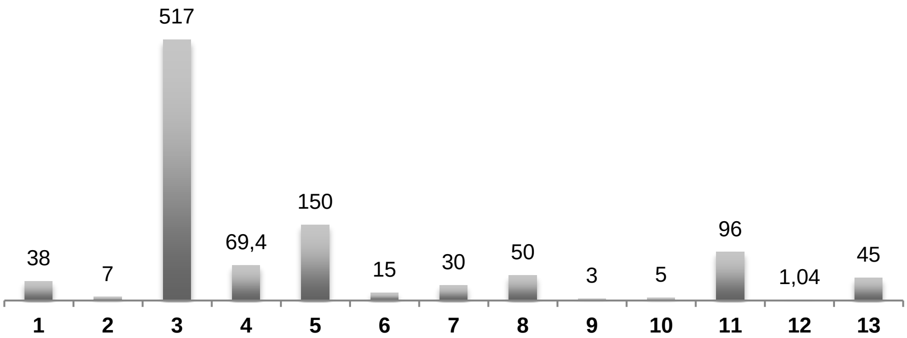


Table A4: Legal Structure of Fund

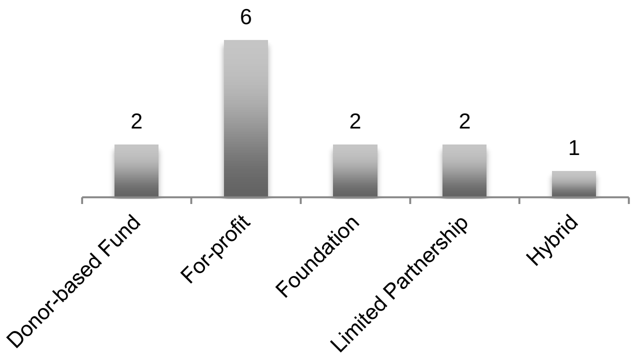


Table A5: Required Deal Size (minimum, in thousand USD)

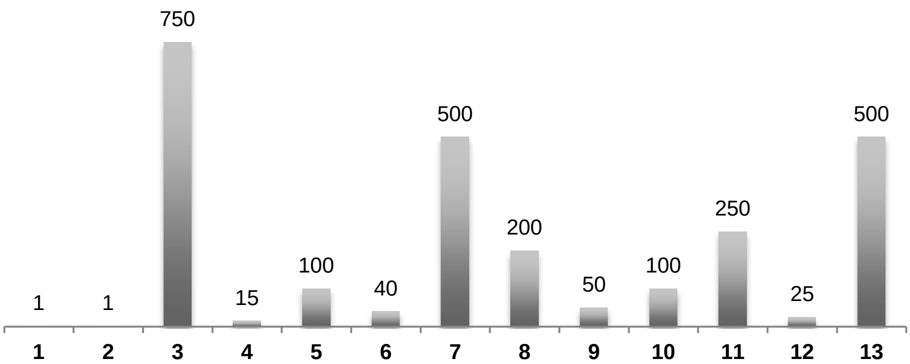


Table A6: Required Internal Rate of Return (IRR) (minimum, in percent) (optional)

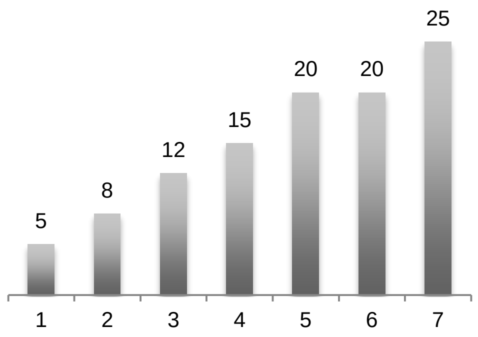


Table A7 Asset Class of Fund (multiple selection possible)

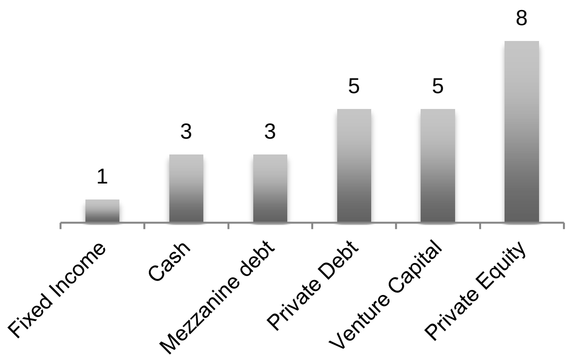


Table A8: Impact Focus of Fund (multiple selection possible)

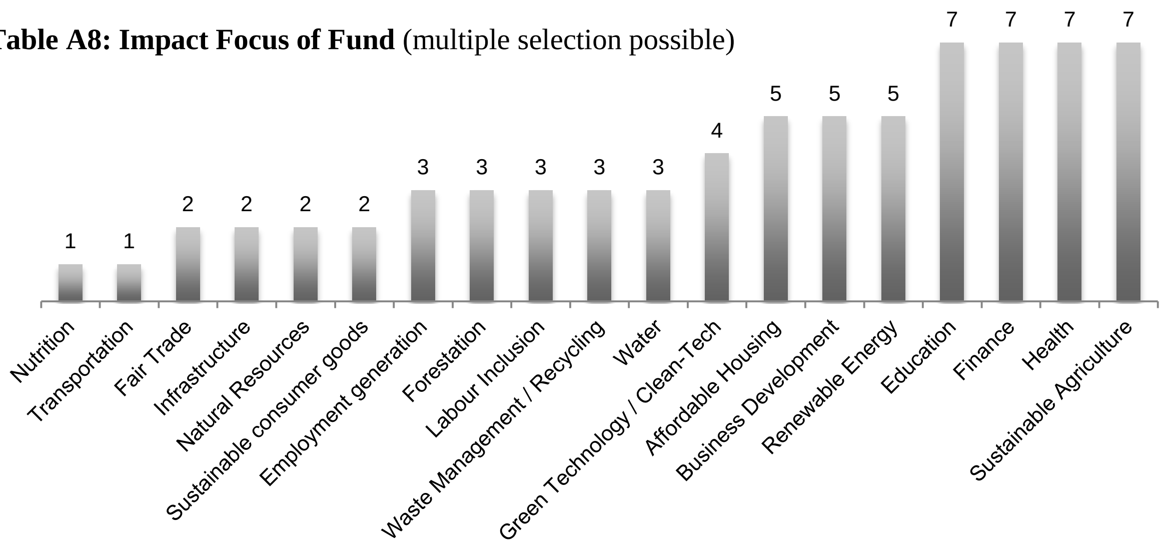
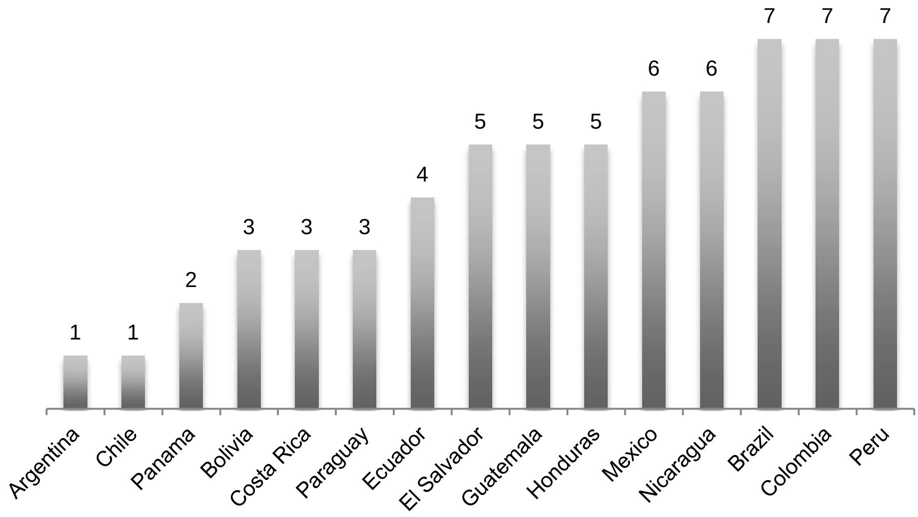


Table A9: Residency of Fund's Portfolio Companies (multiple selection possible)



A.5 Conceptual Issues

The concept of Impact Investing implies the provision of capital and the funding of social entrepreneurs. Foundations, HNWI, persons with an entrepreneurial background or understanding, institutional investors or common investors with the necessary awareness and conscience for tackling a specific social issue may decide to become an Impact Investor. By way of an example, the two following figures outline how interested investors allocate capital and how Impact Investing provides funds to social entrepreneurs. For a detailed description of the Impact Investing model, please refer to Rockefeller Foundation (2012).

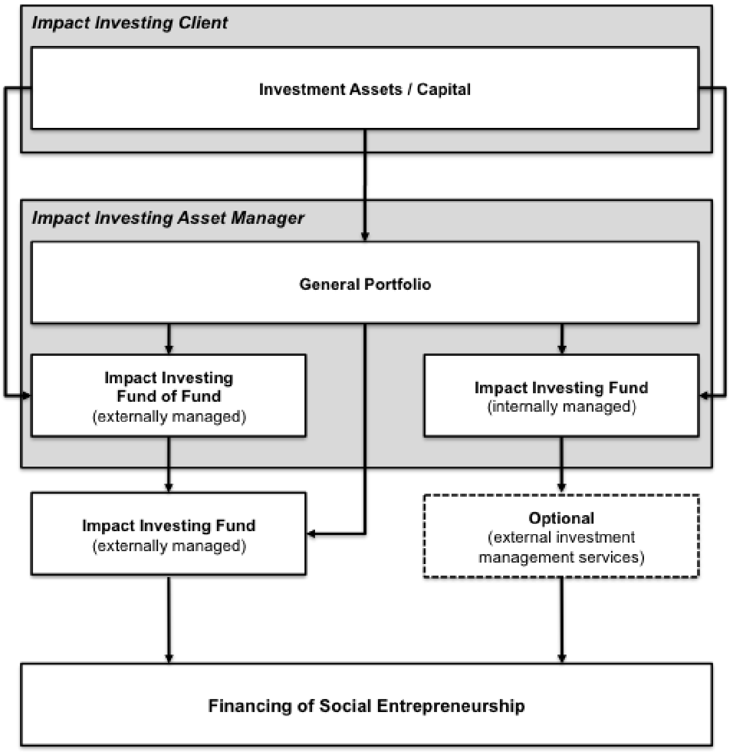


Figure 12: Internally focussed model of Impact Investing

Source: Rockefeller Foundation (2012)

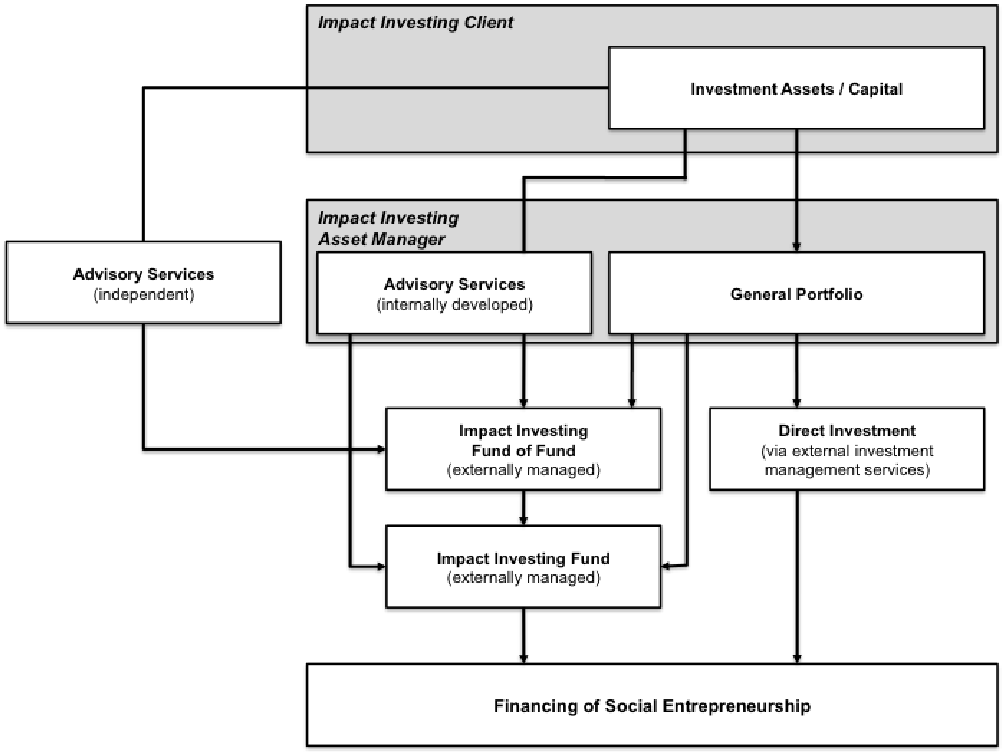


Figure 13: Externally focussed model of Impact Investing