IS SOCIAL ENTREPRENEURSHIP SUSTAINABLE?

Chair: Brian Trelstad, Partner, U.S. Sustainable Growth Fund, Bridges Fund Management; Senior Lecturer, Harvard Business School

Panelists:

- Elizabeth Chou, Growth Initiatives, Leeds Equity Partners, LLC
- Mike Elio, Partner, StepStone Group
- Philip Gaskin, Senior Director, Kauffman Foundation
- Olga Hawn, Faculty Director, UNC Center for Sustainable Enterprise; Assistant Professor of Strategy and Entrepreneurship, Sustainability Distinguished Fellow, UNC Kenan-Flagler Business School

As more investors begin to use environmental, social, and governance (ESG) criteria for investment decisions, tensions have developed in the space. Is impact investing concessionary capital? What are the relevant mechanisms for delivering impact? What is responsible for the shifting priorities of investors in this space? What are challenges to scaling social entrepreneurship? This session brought together four panelists from different parts of the chain of capital to discuss these issues.

Brian Trelstad began the session by arguing that impact investing can be modeled using a “Spectrum of Capital” that spans investing with purely a fiduciary interest in one “pocket” to philanthropic activity in the other “pocket.” In between these two axes are thematic investing, which focuses on delivering impact as well as a market return, and impact-first investing, which identifies opportunities that may require a financial trade-off.

The neoclassical view in academic circles has been that the two “pockets” necessarily involve trade-offs. Investors must sacrifice financial return to achieve impact and vice versa along what Trelstad described as the “Milton Friedman line.” Trelstad questioned how strict the trade-offs implied by the Friedman line are: fiduciary-oriented investing may generate negative externalities and it may not be the case that philanthropy can deliver the same level of impact as thematic or impact-first.

Professor Olga Hawn discussed challenges to delivering impact, including inconsistent ESG metrics and weak mechanisms for implementing impact at the investor level. While the field has made progress on the former by working toward harmonizing ESG ratings, there is still a sizable gap in delivering transformational change. The United Nations estimates that we still need $2.5 trillion USD per year in additional investments until 2030 in order to meet the Sustainable Development Goals. Hawn, citing the paper “Can Sustainable Investing Save the World?,” discussed why this gap still exists despite large amounts of sustainable investments. There are three mechanisms that investors use to impact the world through investments (presented in order of decreasing effectiveness):

1. Growing business that provides solutions to world problems.
2. Promoting best practices for existing companies.
3. Signaling new values in society.

Most sustainable investing capital is invested in signaling and the least amount of sustainable investing capital is invested in providing solutions. Hawn concluded that future ESG ratings should incorporate these three mechanisms and promote growing solutions.
Mike Elio then provided context for LP interest in impact strategy, arguing that millennial investors have adopted responsible investing norms that have historically been the provenance of European investors. The most important shift is that these investors insist on investing with a rising “responsible floor.” Millennial investors in particular are moving toward philanthropy on the Spectrum of Capital. Elio argued that with institutional support from LPs, GPs are more willing to accept and adopt sustainable investing practices.

These developments do not come without challenges. Elio detailed how investments used to be assessed on whether they would fit in the portfolio of a client. Now, this assessment includes an evaluation of whether funds and companies are practicing what they preach. In Elio’s words, “Is it LPA or DNA?”

Elizabeth Chou says the answer for her is “DNA.” She has been actively involved in both early stage and late stage investing in the knowledge industry. She stated that at the early stage there is often a disconnect in expectations: What is this company realistically able to produce? As metrics are rolled up across a set of companies targeting different outcomes, there is also a tension between appropriately summarizing impact without losing the true depth of outcomes. One of Chou’s roles has been to help companies develop and track appropriate KPIs, in addition to helping deliver financial returns. Chou said Leeds believes that investing in companies targeting impact is a profitable venture; if you are investing in a great educational service and consumers demand more efficacious products, the company’s success will follow.

Philip Gaskin then discussed his own history connecting entrepreneurs and the Kauffman Foundation’s approach to inclusive entrepreneurship. In his experience, the biggest challenges facing social impact-minded entrepreneurs are access to capital and finding a connected entrepreneurial community. Kauffman seeks to connect entrepreneurs to communities so that entrepreneurs, particularly underestimated and rural founders, face fewer barriers. These barriers are substantial. Kauffman’s survey of entrepreneurs found that 83% do not access loans or VC funding; 27% of those who receive VC funding attended Ivy League universities; 1% of VC funding goes to African-American founders; and 2% of VC funding goes to women-led firms.

Importantly, the Kauffman approach is that connectedness has to happen and improve at the community level. So long as current systems are unaddressed, these capital gaps will continue to be perpetuated. One way that Kauffman has tested how to be an active part of a solution is by developing alternative funding structures to reach underrepresented communities. Incorporating these communities is a necessary step for creating a sustainable economy.

The panelists reiterated the importance of a consistent impact metric, but believe that the floor is rising for sustainable investing.