COMMENT

Impact venturing emerges

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Are social sector organisations feeling the allure of the venture capital gold rush? Earlier this month, the New York Times reported on a venture investment made by a US non-profit organisation, the Cystic Fibrosis Foundation (CFF), which yielded an astounding $3.3bn return on $150m invested over the past 15 years. The effect on the foundation is transformational, with the proceeds amounting to some 20 times annual operating budget. A very good day indeed.

The allure

Eye-popping financial returns like the CFF's certainly garner a lot of attention. However, for impact-driven organisations, the allure should be less about financial returns but more about creating greater benefit for stakeholders. Venture investing can allow non-profits to partner external investors and companies that can magnify the impact of limited resources and foster new innovations to drive the change the organisation seeks. In return, impact venturing can feed valuable information back to non-profits, keeping them informed of potential disruptions that could affect beneficiaries and organisational strategy, highlighting new and innovative ways to drive change. The mere process of due diligence, for instance, whether funds are invested or not, could yield a cornucopia of new ideas that inform strategy.

Not-for-profit organisations bring a lot of value to the table, independent of financial dollars invested. The CFF was willing to take early bets on a risky venture with distant and uncertain prospects. Non-profits tend to do better than their profit-driven peers at long-term vision and patience, key ingredients for successful venturing. Non-profits also bring a powerful network of supporters, members, thought-leaders, service providers and beneficiaries who might help connect socially-minded entrepreneurs with the communities they seek to serve. Long accustomed to measuring impact through non-financial metrics, non-profits can also help both portfolio companies and fellow impact investors focus on the right measurements. For socially-driven for-profit entrepreneurs in particular, brand affirmation from a reputable organisation can serve as a powerful signal to the marketplace.

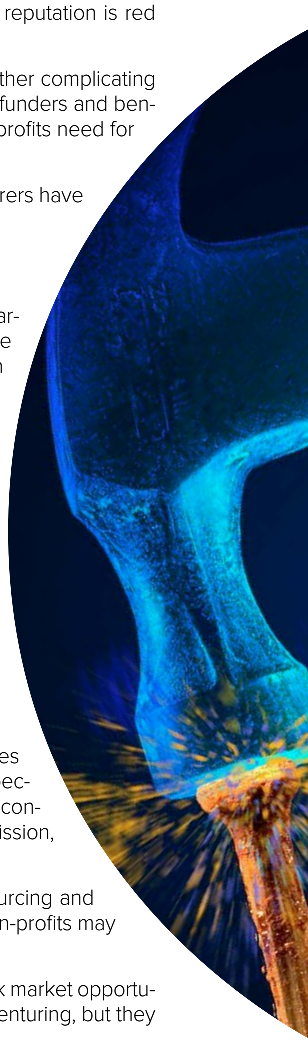
Treacherous waters

The CFF case points to some important risks and pitfalls in impact venturing. Front and centre sit concerns about conflict of interest. Profiteering from the very stakeholders the organisation seeks to serve is already a concern for many earned-revenue opportunities. The risk gets higher as decisions about pricing and service levels are pushed out to venture companies where motives may not align fully with the social mission. Social impact organisations can expect to be held to a higher standard and may be no less accountable for programmes, even if they had no direct control over them.

And what happens when good investments turn bad? In today's world of social media hyper-transparency, the non-profit investor is only one trending hashtag away from a public relations nightmare. A firestorm set off by ill-placed comments from a portfolio company executive could come back quickly to haunt a non-profit, whose vaunted reputation is red meat for a media feeding frenzy.

More subtly, the introduction of portfolio companies potentially adds a new class of stakeholders, further complicating strategy. How well these new stakeholders get along today, and in the future, with the organisation's funders and beneficiaries requires solid contingency planning. One early source of tension may lie between the non-profits need for transparency with the private sector's penchant for remaining private – at least until going public.

On top of all this, social sector venture capitalists are subject to the all same risks that corporate venturers have to deal with, including the fact that funds may be tied up for a very long time and may even disappear.



Key considerations before you begin

What can your organisation afford? Clearly, tying up vital resources for long periods of time with no guarantee of success is tough for any non-profit. The good news is that venturing does not have to involve huge sums of money. We have seen corporate venturing funds participate in investment rounds with as little as $500,000.

How well will venturing fit with the organisation's culture? Indeed, we might speculate that grant-making foundations, with a long history of evaluating grant proposals against clear criteria, may have a more intellectual and cultural mindset for venturing than their hands-on programme-minded peers.

How will the board be engaged? Board members can lend expertise and connections to set up a successful program, define mission-driven criteria, provide governance to enforce discipline and help prepare for and deal with risk scenarios.

How will the organisation manage the process and absorb lessons? One lesson from the corporate venturing world points to the merits of establishing a separate venturing group, distinct from programmes and traditional grant-making teams but well connected to the core groups. Successful corporate venturers also manage their portfolio to produce lessons that come back into the core organisation.

What is the most strategic investment focus? It is vital to articulate focus areas, criteria and processes clearly up front, and apply them, learn and revise regularly. A combination of inside and outside perspectives helps to keep strategy on track and relevant. To get the most of the programme it is important to connect at the start with strategy by considering the range of potential disruptions that could affect the mission, beneficiaries or stakeholders and cultivate a portfolio around that core.

Are there natural alliances and partnerships you can cultivate? For any organisation lacking deal-sourcing and structuring expertise, it is important to cultivate relationships with financial investors who can help. Non-profits may further refine the field by identifying impact investors who are harmonious with their mission.

The next 10 years promises an explosion of new opportunities for non-profit organisations, as they seek market opportunities for driving impact and sustainability. Indeed, in some ways non-profits have a distinct edge on venturing, but they must understand and avoid the dangers, lest a gold rush turn into a frenzy of fool's gold. ◆