Four Revolutions in Global Philanthropy

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Philanthropy is currently undergoing four revolutions in parallel. This paper identifies and analyzes the four main fault lines which will influence the next decades of global philanthropy. All are related to what we can refer to as the market revolution in global philanthropy. As global philanthropy moves beyond grantmaking, into investment approaches that produce a social as well as a financial return, this accelerates the mainstreaming of a variety of niche activities. They marry effectiveness, social impact, and market mechanisms.

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1. Global Philanthropy: A Field in Transition

This paper discusses the key theatres of change in global philanthropy: amplifying social entrepreneurship through synthetic social business; the shift from microfinance to inclusive financial services; the abandonment of the paradigm of development assistance in favor of base-of-the-pyramid investments; and the transition from classical grantmaking to an entrepreneurial internalization of externalities that uses public-private-civil society value chains.

As the UK recovers from its 2008-2009 recession, Jeremy Hunt, the UK Culture Secretary, recently dubbed 2011 the year of corporate philanthropy; he also announced a review on ways to encourage more giving. Lord Wei, a UK cabinet office adviser and architect of the UK government Big Society vision which aims to take activities closer to their communities, provided by business, local authority spin-outs, voluntary organizations or citizens directly, went further and argued that "we can't run things for the next 60 years the way we did for the last 60." So how can we run them? A few months earlier, then UK Justice Secretary Jack Straw announced the world's first Social Impact Bond pilot.[1]

Based on a contingent return model, it aimed to mobilize up to GBP 5 million for several specialized charities that work with the Peterborough prison in Cambridgeshire, England. The charities will provide a range of mentoring, education and social support services for 3,000 male prisoners who have been sentenced to less than a year in jail. The UK Justice Secretary argued: "It's the short-term prisoners who have the highest propensity to reoffend. This bond will help to moderate increases in the prison population and produce a benefit for society". The chief executive of the St. Giles Trust, one of the specialized charities selected to deliver services at Peterborough, described the bond as a "funding revolution". The model is straightforward: the investors will receive a dividend from the government only if the program achieves a reduction greater than 7.5 per cent in reoffending among the prisoners covered by the program, who are measured against an equivalent control group on the UK police national computer. The returns are contingent on success: the more money UK state agencies save through the program, the higher the return paid to bond investors, rising to a maximum of 13%, with payments made during years six and eight. If successful, the pilot has high replication potential because of the program's estimated effectiveness and the scale of the reoffending problem. One Pound invested in a St. Giles Trust project to support prison leavers is estimated to save the government ten Pounds. In fact, the UK National Audit Office estimates that reoffending by the 60,000 prisoners serving sentences shorter than 12 months is costing the UK up to GBP 10 billion per year.[2]

The story of the Social Impact Bond provides an entry point to some of the changes under way in the field of global philanthropy.[3] Around the world, philanthropy – defined as the provision of private resources for social purposes, either in the form of grants or of "social" or "impact" investments generating a financial as well as a social return – has significantly expanded in scale and visibility in the past decade. There has been a widespread, contagious enthusiasm about a new golden era of philanthropy, called into question only temporarily during the recent great recession.

The Social Impact Bond embodies three aspects of the transformation under way: first, the bond's innovative contingent returns model; second, the execution partnership between a private social sector organization and a government agency in the provision of a core public good, safety; and finally, the role of social entrepreneurship in the conceptualization and implementation of the approach. The UK Social Impact Bond is run jointly by the UK Ministry of Justice and Social Finance. (Social Finance is an ethical investment organization founded by private equity veteran Sir Ronald Cohen and others in 2007 with the stated objective of developing an effective social investment market in the UK. Run by CEO David Hutchinson and founder and development director Toby Eccles, taking contingent returns from an idea to a product has been a long socially entrepreneurial road in its own right. Multiple other collaborative entrepreneurs were involved along the way since the contingent returns idea was first articulated six years ago at a workshop in the context of Ashoka's social finance work, then led by Arthur Wood).

Due to their political independence, capacity to engage in the long term and the ability to pursue social change objectives in multiple jurisdictions, philanthropic foundations are seen as highly effective change agents. Many philanthropists around the world are ambitious, sophisticated and entrepreneurial. They ask how they can maximize the catalytic effect of their philanthropy and how social enterprise and market-based mechanisms can be tapped as additional conduits for social change.

To understand the philanthropic field's logic of action, we need to understand what the rules of the game are and how fields develop. It helps to bring Kurt Lewin and Pierre Bourdieu's notion of a "field" to bear on the analysis.[4] Social interaction inevitably takes place in a context, and this holds true for philanthropy as well. Thinking of philanthropy as a field foregrounds its multiple dimensions and its semi-autonomous nature. Trends in global philanthropy are broadly related to trends in other domains, but they do not mirror them mechanically.[5] Based on the interplay between their location in a social network and their outlook on life, individuals such as philanthropists, foundation leaders or social entrepreneurs and institutions in the social capital market occupy specific positions in a given field.[6] Over time, the specific positions they carve out crystallize in a field-specific logic of action. Actors' actions translate into what we know as the history of the field of philanthropy. While not fully insulated from the dynamics in other fields, a field's specific history might differ considerably from overall historic developments. The current transformation of global philanthropy coincides with a broad-based market revolution and globalization, but the fields are by no means identical.

Fields such as global philanthropy are governed by "rules of the game"[7]: actors who do not master these rules will not be able to make meaningful interventions. To make sense, one must act according to the field's "logic of action". Thinking about global philanthropy as a field reminds us that in spite of all the passion, the relevant parties are historical actors. They are constrained by the spirit of their times, and benefitting from the work done by previous generations.

A spectacular development of interest in philanthropy is under way among wealthy individuals around the world. There are multiple reasons: deep-seated worries about the environmental and social trajectory of the planet, the inability of established institutions to meet social needs on a massive scale, skepticism about the future of financial markets, and the desire to pass on family values to the next generations in a world that is characterized by so much change. Today, one in five wealthy individuals around the world is actively involved in philanthropy. Many more would like to get involved in the big questions of our times, but are not sure how.

Moreover, involvement mechanisms diversify away from grants. A recent report by J.P. Morgan and the Rockefeller Foundation ("Impact Investments: An Emerging Asset Class") analyzed over 1,000 impact investments in five sectors — housing, water, health, education, and financial services – that target global populations earning less than US$ 3,000 annually. In the field of impact investments in these sectors alone, the report estimates a US$ 400 billion to US$ 1 trillion investment opportunity, with potential profits ranging from US$ 183 billion to US$ 667 billion over the next decade.

Taken together the revolutions discussed below will in due course fundamentally reshape the way we give, work and live. They are part of a broader development where business moves beyond a sheer focus on profit, and philanthropy beyond grantmaking. We refer to this form of organization and economy as "impact economy".

This paper discusses the key theatres in some detail in the sections below:

- (1) Amplifying social entrepreneurship through synthetic social business
- (2) From microfinance to inclusive financial services
- (3) From development assistance to base-of-the-pyramid investments
- (4) From classical grantmaking to entrepreneurial internalization of externalities

In the next section, the paper first discusses the general shift away from inefficient social capital markets, where resource allocation is relationship-driven, to a more value driven allocation, as highlighted in the case of the Social Impact Bond above. Grants are expensive to raise and tend to be restricted to funding current service provision. Transaction costs in grant funding tend to be stifling, in addition to requiring an excessive time commitment to fundraising from the top leadership of the grantee organizations. As a result, non-profit organizations enjoy insufficient flexibility to adapt, change and invest in their workforce or infrastructure.[8] This section analyzes the constraints and the need for an increasingly efficient social capital market.

Subsequently, the paper examines the four revolutions in global philanthropy, starting with the shift from social entrepreneurship to synthetic social business. Social entrepreneurship is one of today's key frontiers in global philanthropy. Social entrepreneurs typically use market mechanisms to deliver a good or a service in a highly effective fashion to a marginalized or poor population that would not have the same level of access to the good or service otherwise. The section examines the experience of "Ashoka: Innovators for the Public", and Aravind Eye Hospital in India. It argues that social entrepreneurship is becoming increasingly supply-constrained and will therefore begin to enter a new phase where organizational design features and incubation efforts in addition to charismatic individuals will serve as guarantors of sustaining a socially entrepreneurial mission in scale, a phenomenon referred to here as "synthetic social entrepreneurship" and "synthetic social business".

The paper then examines a second frontier of global philanthropy, that of microfinance and its shift to a broader paradigm of inclusive financial services. With approximately 2.5 billion people from low-income countries and many of the 2.7 billion people from middle-income countries still underserved by the conventional financial services industry, microfinance is an important theater of the overall market revolution in philanthropy, deploying market mechanisms for the empowerment of the economically active poor. The section reviews how the microfinance field has successfully gone through different stages leading to the emergence of a new asset class and a US$ 25 billion market with roughly 100 million borrowers, with a potential demand of 500 million borrowers and a market size of US$ 250 billion. We discuss the example of Banco Compartamos, and then look at the current transition from a focus on credit to inclusive financial services.

The paper's following section looks at global philanthropy's third frontier, the shift from development assistance to base-of-the-pyramid investing. At the core of the argument are the implications of the recent re-conceptualization of the Third World or developing world as the so-called "base of the pyramid" (BoP). BoP refers to a gigantic market with four billion people and pent-up demand for a whole range of goods and services in areas such as education, health, housing and sanitation. Shifting from development assistance to base-of-the-pyramid investing assumes that a joint deployment of capital, professional expertise, technology and the local presence of a commercial investor with a global network can unlock significant economic and social benefits where development aid has often failed. The section examines the cases of the Africa Health Fund in the UK and Ignia Ventures in Mexico.

Subsequently, the paper discusses global philanthropy's fourth frontier, the transition from classical grantmaking to a grant-based entrepreneurial internalization of externalities that brings public, private, and civil society actors into a joint value chain. Grants remain the core business of philanthropy today; many of the fundamental challenges humanity faces in the twenty-first century cannot be tackled by markets alone. Free markets do not internalize externalities such as environmental destruction or negative public health impacts on populations that are not working in the formal sector. Private or public subsidies are required. In some cases, they should be temporary, and directed toward establishing functioning market places. In other cases, concerning pure public goods, subsidies are required on a permanent basis to achieve a given social objective. The section maps the grant-based entrepreneurial internalization of externalities, using capital markets to monetize grant commitments in one of three cases: (1) whenever addressing a problem now is cheaper than addressing it in the future, when a grant commitment is actually paid out, (2) when new market places need to be constructed, or (3) when the most efficient solution provider is not a government agency. The Global Alliance for Vaccines and Immunization (GAVI), the World Sanitation Financing Facility (WSFF) and the Social Impact Bond are discussed to highlight the different changes under way in the grantmaking space.

The paper’s final section resumes the argument and asks where global philanthropy is ultimately headed. Thinkers like William Petty, Adam Smith, and John Stuart Mill argued for centuries for the large-scale provision of public goods by governments, which only became a reality with the rise of the welfare state in the industrialized world in the twentieth century. The concept of public goods is now omnipresent in framing policy discussions. But given the state of public finances around the world and the suboptimal innovation orientation of the public sector, a window of opportunity has opened up for a philanthropy-facilitated provision of public goods on a massive scale through market-based solutions. There is no practical reason why the techniques and concepts of investment banking and capital markets cannot be applied to solving some of the most pressing social challenges of the twenty-first century. The implications of the recent financial crisis are likely to accelerate the transformation of the field of global philanthropy.

2. From Inefficient Social Capital Markets to Value-Driven Allocation

Global philanthropy increasingly seeks to address social and environmental needs of great magnitude. The high transaction costs of grant financing can leave philanthropists frustrated as they seek to make a difference. But while there has never been a broad constituency for efficiency and effectiveness in the history of philanthropy, two interesting developments are likely to enable philanthropies to achieve greater impact in the decades to come: value-driven allocation instead of relationship-based donations, and investments in addition to grants.

As a secular trend, philanthropy is gradually moving away from a relationship-driven toward a value-driven allocation of capital. This is changing the logic of the philanthropic field and will create an increasingly efficient social capital market over time.

To appreciate this argument, let us first look at the status quo. The leading philanthropic foundations in some cases surpass governments in the scale of the budgets they deploy to solve specific social issues. They benefit from economies of scale and scope in their grantmaking processes and agenda setting. The 2009 budget of the Bill and Melinda Gates Foundation, the world's largest foundation, was US$ 3.8 billion, which does not fall far short from the World Health Organization's (WHO) US$ 5 billion budget. The marked difference is that the foundation is not controlled by 193 member countries, as is the WHO, but by a foundation board with only three trustees: Bill and Melinda Gates, and Warren Buffett.

The majority of charitable foundations operate on much smaller budgets, however. Moreover, similar to grant-seeking civil society organizations, grantmaking organizations follow a wide range of theories of change and impact assessment, allowing for little standardization of processes and efficiency gain potential across organizations. Foundations operate in a fragmented resource allocation system with high search and capital allocation costs.

Not only does an individual or organization looking to participate in the philanthropic sector face a bewildering array of players; in many countries the processes of non-profit registration are also complex, tax incentives discouraging and sector regulations cumbersome. In short, the social capital market is not fully efficient.

In addition to the sheer transaction costs of allocating philanthropic capital, proponents of the "inefficient market hypothesis" also note that too little value-driven allocation takes place in philanthropy.

The majority of grantmaking is currently not based on non-profit performance, but highly relationship-driven instead. Philanthropists and social investors therefore do not necessarily reward better performers with additional resources. Putting a cost to this structural inefficiency, one study of the US non-profit sector put the combined costs of grantmaking and fundraising as high as 22% to 43%, that is, ten times higher when compared to a cost of 2% to 4% of allocating capital in the stock market.[9] Compared to capital allocation processes in public markets, where success is measured in terms of a single metric – profit – the "social capital market" looks disappointingly inefficient: transaction costs are too high, information flows insufficiently robust to reward performance, and investor preferences often overly influenced by relationship considerations.

As a symptom of the social capital market's inefficiency, non-profit leaders typically spend vast amounts of time on fundraising rather than on the continuous improvement of the work of the organizations they lead. This even holds true for organizational models that are considered to be especially innovative and effective, as in the case of social entrepreneurs. For example, a global survey among 109 social entrepreneurs by UK strategy consultancy and think tank

SustainAbility revealed a lack of efficient capital allocation processes in this segment of global philanthropy as well: 72% of the social entrepreneurs interviewed considered accessing capital to be the main obstacle to growth, next to marketing and the further professionalization of their organizations.[10]

A substantial portion of giving is likely to continue to be relationship-driven in the foreseeable future. But its proportion will nevertheless diminish substantially over the next decades as impact-driven philanthropy and impact investing take off. The relative importance of philanthropic capital seeking high demonstrated social returns is increasing. Some observers even argue that we are on the verge of a new social movement led by the wealthy. UK journalist Matthew Bishop and former UK development aid official Michael Green have termed this phenomenon "philanthrocapitalism".[11] In this view, the subset of philanthropy which seeks to provide transformational solutions to the issues it takes up has entered a qualitatively new phase in human history. Propelled by motivated business and celebrity philanthropists such as Bill Gates, Bono, Richard Branson, Angelina Jolie or George Soros, it has become a veritable movement.

Global philanthropy is not only becoming more results-oriented with the grants it allocates. It has also entered a healthy period of experimentation by blending social and financial returns. This mirrors trends in mainstream investing, where globalization and geopolitical events increasingly drive capital towards under-attended populations, and emerging market investments are becoming more relevant. Philanthropy now also experiments with for-profit models that create opportunities to do good and well at the same time.

In terms of the gradual unfolding of a new approach, there is a parallel with ethical funds, sustainable investments and socially responsible ventures. Commonly aggregated under the umbrella term Socially Responsible Investments (SRI), such investments went through a long phase of uncoordinated innovation. They have finally seen substantive growth in recent years, and are now becoming a part of the mainstream in the investment space. In 2006, the market for SRI funds was estimated to be around US$ 2.2 trillion in the US alone, and over EUR 1 trillion in Europe, accounting for 10% to 15% of assets under management; in spite of the financial crisis, in the period 2008-2010 total socially responsible investment assets under management (AuM) in Europe increased by 87% from EUR 2.7 trillion to EUR 5 trillion (as of December 31, 2009).[12] Wake-up call events such as the risks and liabilities resulting from the BP Deepwater Horizon case make it clear to investors how environmental and social risks have significant long-term financial consequences. Notwithstanding, global SRI assets still stood at only US$ 7 trillion at the end of 2009. As is generally the case in a maturing industry, the number of actors has multiplied, forming a cluster. The array of SRI actors is impressive: in Europe alone, there were an estimated 879 SRI retail funds at the end of 2009, up from 683 a year earlier and an estimated 375 SRI funds in October 2007. Growth in France, the SRI leader in terms of volume with EUR 26.5 billion at the end of 2009, was partly due to shifting retail banking policies where some money market funds switched to SRI strategies in response to investor demand.[13]

As the equivalent of SRI conquers the foundation world, what does this mean? There are multiple concepts for doing good and well at the same time. Over the years, the approach has therefore come to be referred to under different labels. The concepts of blended-value investing, mission-investing, or impact investing all are based on a shared core idea: to invest (a part of) a foundation endowment or some other philanthropic asset to achieve both financial and social returns.

Conceptually, this is highly attractive. If a charitable foundation looks holistically at expenditure and investment policies as complementary ways to further its mission, it can generate greater social impact. In addition to distributing 2% to 5% of assets every year, a foundation could also invest some part of the other 95% to 98% of its assets in investments furthering its mission, provided it can do so without sacrificing the financial returns on endowment assets that are required to finance payouts in perpetuity.[14]

While the idea is intellectually straightforward, it has so far not been adopted widely in the global philanthropic community. In spite of multiple attempts by practitioners to advocate a unified view of investment policy and payouts, a lot remains to be done. The foundational concept is elegant and clear, and at some point one of the initiatives should succeed. The most recent high-profile effort in global philanthropy to invest financial assets for social and financial returns is the Global Impact Investing Network (GIIN).

The GIIN was conceived in October 2007 and in June 2008 in Bellagio, Italy, where the Rockefeller Foundation gathered a small group of investors to discuss how to solve social and environmental challenges with greater efficiency. At the second meeting, a group of 40 international investors organized themselves under the framework of several initiatives. The work streams included:

(1) The creation of a global network of impact investors,

(2) The development of a standardized metrics framework to assess the impact of such investments in social and environmental terms, and

(3) A special working group of investors focusing on sustainable agriculture in sub-Saharan Africa.

In 2009, the GIIN was then formally constituted as an independent organization with US 501(c) 3 charitable status under the fiscal sponsorship of US non-profit strategy firm Rockefeller Philanthropy Advisors (RPA). The initiative forecasts the emergence of a US$ 500 billion impact investing industry over the next five to ten years, recently updated to investment opportunities ranging from US$ 400 billion to US$ 1 trillion, as mentioned earlier.[15]

Case 1: The Global Impact Investing Network (GIIN)

As capital allocation transitions from relationship-driven to value-driven, there are in principle many sectors where one could easily consider impact investments: sustainable development, clean energy, microfinance, water and sanitation, and housing and small enterprise, to name just a few. Notwithstanding, the challenge consists of moving from isolated experiments and small investments to implementation in scale. This is a prerequisite for the emergence of a new asset class. Investor education is particularly important to achieve widespread adoption of impact investing as a generally accepted investment framework. It would be disappointing if impact investing became a reputation game where foundations and philanthropists content themselves with chasing a few small transactions to tick the innovation and impact box, without however achieving greater social impact with the bulk of their financial investments over time.

Moreover, many foundations and philanthropists still hold a binary view: as donors, they are happy to make grants that have no financial return.[16] By contrast, as investors they prioritize financially profitable investments – albeit deploying very conservative investment strategies when acting as foundation board members. From a social impact perspective, this preference is counterintuitive. In terms of market efficiency, the optimal intervention in social and economic terms cannot be decided in isolation of the issue which a philanthropist seeks to address. It is likely to fall somewhere between these two binary opposites. Some funds deployed may never provide a direct positive economic return although they may contribute to positive change indirectly, for example through democratic development and upholding of human rights.

In this gradual move of global philanthropy from inefficient social capital markets to value-driven allocation, the examples of substantial innovation are multiplying. New allocation processes are coming on stream. They use investment mechanisms to steer capital toward pressing social and environmental issues more efficiently. If and how quickly these approaches will become mainstream is literally the sector’s trillion-dollar-question. But if anything, the recent downturn has accelerated the pace, as is already evident in the case of SRI. Over the long term, the emergence of an impact investing industry (whatever its ultimate name might be) can be considered to be a reasonably certain outcome, reducing the inefficiency of social capital markets and increasing the role of value-driven allocation.

The paper now analyzes the four key revolutions under way that will render philanthropy a lot more effective. In due course they will even help to establish an impact economy where mainstream for-profit players target economic *and* social value: social entrepreneurship, microfinance, base-of-the-pyramid investing, and innovative grant finance. Jointly, they will transform the philanthropic field in fundamental ways in the coming decades.

3. Revolution One: Amplifying Social Entrepreneurship through Synthetic Social Business

In formation since the 1970s, a veritable global field of social entrepreneurship has emerged since the turn of the millennium. More and more mainstream institutions look to funding quality social entrepreneurs. We are now about to reaching a point where the relative supply of high-performing individual social entrepreneurs is becoming constrained vis-à-vis demand for such talent. We therefore need to find new ways to create additional supply. We refer to this insemination process as "synthetic social business" and "synthetic social entrepreneurship".

Social entrepreneurship is one of the key change theatres in global philanthropy. Though referred to extensively as a concept and at the core of an emerging social movement, there is no single definition of the subject. Defined as finding ways to combine existing resources in novel ways that yield added social value, social entrepreneurship is a perennial phenomenon: throughout human history, there have been people who have found innovative ways to fulfill social needs. But great social scientists such as Emile Durkheim or Max Weber did not write about social entrepreneurs when they sought to understand and explain what was happening around them in the age of industrialization and colonial globalization, more than a hundred years ago.

As understood today, social entrepreneurs typically use market mechanisms to deliver a good or a service in a highly effective fashion to a marginalized or poor population that would not have the same level of access to the good or service otherwise.

The concept of social entrepreneurship began to be theorized in the 1980s, based on the work of Bill Drayton, the founder of the pioneering institution of social entrepreneurship, Ashoka. Social entrepreneurship was widely discussed in the media for the first time in the 1990s. Subsequently, an increasing number of individuals and organizations began to devote their attention to elaborating some aspect of social entrepreneurship. In 2010, there were several thousand social entrepreneurs organized in global networks. Many more individuals and organizations referred to themselves as social entrepreneurs or social enterprises. A sense emerged that social entrepreneurship might be the key ingredient to a new social contract for the twenty-first century.

Given all the attention, when assessing the promise of social entrepreneurship, it is important to look at the soundness of the underlying model and understand that no matter how effective, bottom-up evolution takes time. Typically, a social entrepreneurial approach results from trial and error rather than top-down planning. Many successful intervention models were pioneered in the 1970s and 1980s, then began to spread around the world in the 1990s, and were systematically globalized in the 2000s. Successful social entrepreneurs combine lessons from the world of business and the world of civil society, and benefit from the global exchange of expertise and access to networks.

Take the emblematic example of providing low-cost cataract eye operations at the Aravind Eye Hospital in India. Focused on providing affordable, sustainable and equitable eye care in order to treat preventable blindness, Dr. Vanketaswamy (often simply referred to as "Dr. V."), set up the hospital in 1976. Both deeply spiritual and extraordinarily focused on efficiency, he reminded his staff constantly "if McDonald's can deliver affordable hamburgers to the common person everywhere in the world, why can't we deliver eye care to everyone who needs it?" Keeping costs in check was one necessary condition to achieve scale. In the 1980s, David Green, then a fundraiser for the Seva Foundation in the United States, and later nominated an Ashoka Fellow, successfully raised large volumes of in-kind donations of intraocular lenses (IOLs) from U.S. manufacturers needed to perform cataract operations at low cost at the Aravind Eye Hospital in India.[17] Free lenses provided a core input necessary to scale the number of eye operations while keeping costs in check. Moreover, the Aravind Eye Hospital succeeded in redesigning the surgery process along the lines of scientific management, creating a low-cost eye operation value chain with standardized, quality outcomes.[18] When Aravind's in-kind donation stream of IOLs dried up in the late 1980s due to a change in industry dynamics, the high cost of IOLs in the market, in excess of US$ 125, became a constraint for operating at scale.

In response, David Green helped to establish a non-profit organization, Aurolab, as the manufacturing division of Aravind Eye Hospital. In a remarkable exercise in technology transfer, Aurolab managed to manufacture high-quality IOLs at affordable prices – about US$ 5 a pair. Since 1992, Aurolab has supplied over 5 million lenses to its customers in India and over 120 other countries worldwide. Charging higher prices to wealthier patients made cross-subsidies to the poor possible, operating them at very low cost or for free. In 2009, Aravind treated about two thirds of its patients for free. The remaining third of the patients were charged above cost and subsidized those who were not able to cover the full cost of the operation. The delivery chain is designed to ensure that this price discrimination works. Every patient receives the same quality cataract operation. But patients who are treated for free are placed in more Spartan accommodation than paying patients. To get access to better post-operation facilities, those who can do choose to pay the full rate. Given its low cost base and secure access to core components, the Aravind cataract operation business is in principle very profitable.

Once the Aravind Eye Care system ran smoothly, David Green began to consult to other eye care systems around the world to enable them to become self-sustaining. Since 2000, this has enabled approximately 250 eye care programs globally to become profitable while offering quality services to the wealthy and the poor alike via price discrimination schemes. In the Middle East, David Green was introduced to ophthalmologist Akef El Maghraby in Egypt; together they developed what became the largest eye care program in the Middle East, the El-Maghraby Eye and Ear Hospitals and Centers.

Case 2: Aravind Eye Care

Over the past thirty years, several social entrepreneurs have managed to create social businesses such as Aravind, which are in principle financially sustainable and even profitable. This has led social entrepreneurs to take steps to further scale and replicate such initiatives.

One of the most interesting developments in this respect is the use of financial engineering to tap additional financial resources, often on quasi-commercial terms. Properly run and scaled, such programs generate sufficient cash flow to support debt financing at manageable levels of risk. This means that in principle, they should be able to access capital markets on commercial or quasi commercial terms, provided the proper financial product is designed to do so. In the case of the Aravind model, Ashoka, the world's leading network of social entrepreneurs and a

US-headquartered non-profit that identifies, nurtures and networks social entrepreneurs around the world, and the International Agency for the Prevention of Blindness (IAPB) teamed up with Deutsche Bank to create Eye Fund 1. A US$ 20 million debt fund, it provides loans and guarantees to support the development of affordable, sustainable and accessible eye care for the world's poor by financing the scaling up of eye-care hospitals in developing countries.

Almost parallel to the pioneering work of social entrepreneurs in the field, the institutionalization of a support infrastructure for social entrepreneurship began about thirty years ago in North America. Bill Drayton founded Ashoka, in 1980.[19] Over time, the organization expanded to more than seventy countries. A US based non-profit organization with offices around the world, Ashoka is dedicated to finding social innovators with powerful emergent ideas. It supports and networks them so that they can focus on the implementation and scaling of their vision. Today, Ashoka has over 2,500 quality social entrepreneurs in more than 70 countries in its portfolio. Over time, more and more organizations focused on finding and funding social entrepreneurs were founded, for example the Schwab Foundation for Social Entrepreneurship, created in Switzerland in 1998 by Klaus Schwab, the founder and President of the World Economic Forum, Geneva, Switzerland, and his wife Hilde; or the Skoll Foundation, based in Palo Alto, California, and founded in 1999 by Jeff Skoll, the first President of eBay. Subsequently, additional institutions dedicated to the identification, support and study of social entrepreneurship were set up around the world as well.

In the 2000s, universities around the world began to integrate social entrepreneurship into their curricula. In the United States, courses on social entrepreneurship had been offered since the 1990s, when Harvard Business School launched its Social Enterprise Initiative in 1993. Europe's first university course on social entrepreneurship started to be offered at the University of Geneva, Switzerland, in 2003. IESE Business School in Barcelona and the Saïd Business School at Oxford University started to offer courses in 2004.

In some cases, government also encouraged and funded social entrepreneurship. It held the view that civil society organizations can be a highly effective complement to the public delivery of public goods, a perspective that is discussed in a later section of this paper. For example, in the UK, the Millennium Commission granted an endowment to the Millennium Awards Trust in 2002 to fund the activities of UnLtd, Foundation for Social Entrepreneurs, and a UK registered charity.

As social entrepreneurship as an organizing concept for innovative social change work gained traction in the Americas, Europe and Asia, a further development became noticeable: many established players in civil society and philanthropy self-assigned the label social entrepreneurship to their work. Non-profit leaders and university graduates alike began to recast themselves as social entrepreneurs. Social entrepreneurship had become a part of global consciousness.

Thus, since the turn of the millennium, a veritable global field of social entrepreneurship has emerged. More and more mainstream institutions looked to funding quality social entrepreneurs. Notwithstanding, one of the key questions going forward is how to fund social entrepreneurs efficiently. While the non-profit sector is large and growing, it continues to be highly fragmented – for social entrepreneurs and more classical non-profits alike. Raising costs and adding complexity, this holds back investment. Consider that of 200,000 non-profits founded in the US between 1970 and 2003, only 144 had reached revenues in excess of US$ 50 million by 2003.[20] Fragmentation may lower the entry barrier for innovation, but it imposes higher transaction costs and renders expansion more difficult. Compare the due diligence and portfolio management costs to be borne by a 100 million US$ debt or equity investment vehicle, with 100 portfolio investments of US$ 1 million each, to a more standard private equity investment vehicle of the same size, where the average investment is US$ 10 million. Assuming a typical private equity screening ratio of 100 opportunities for every investment made, the first vehicle would have to find, screen and monitor 10,000 opportunities. The latter has to find, screen and monitor only 1,000. Moreover, in terms of effort-reward ratio, it is typically harder for social businesses to achieve full financial viability than for purely commercial ventures.

Scale and funding efficiency are not the only challenge. In the 2010s we are about to reach a point where the relative supply of high-performing individual social entrepreneurs is becoming constrained vis-à-vis demand for such talent. The problem is straightforward: there are not that many "Dr Vs/Aravinds" that can be scaled further if additional finance is tapped through financial engineering. On a sustainable basis, and as a rule of thumb, one can find about one additional Ashoka-quality social entrepreneur per annum per 10 million inhabitants. This means that we could in principle source 680 new social entrepreneurs per annum (at a current global population of 6.8 billion) through this channel.

Logically, one goal therefore has to be to enable these social entrepreneurs to reach scale faster. But the pool also needs to be enlarged. As social entrepreneurship matures and becomes a veritable social movement, new channels are now coming on stream to breed social entrepreneurs and social enterprises.

Let me refer to this phenomenon as "synthetic social business" and "synthetic social entrepreneurship". The outcomes are real rather than artificial, but the process is synthetic: specific steps are taken to incubate cohorts of social entrepreneurs and social enterprises. The goal is simple: to enlarge the pool of potential social entrepreneurs and social enterprises.

One channel consists of raising supply through "insemination" at the university level, or "synthetic social entrepreneurship". Business schools around the world develop management talent on a massive scale, so it is currently much less scarce than social entrepreneurship talent. Given the interest of students around the world in the topic, the latter is growing fast, but from a low base. Steps can be taken to accelerate this process.

In 2010, Ashoka University conducted the first-ever Faculty Institute at Marquette University in Milwaukee. Taking a train-the-trainer approach, the Institute trains senior faculty in the design and delivery of effective courses on social entrepreneurship. It thereby dramatically raises the supply and quality of social entrepreneurship education at the university in question.

The Institute substantiates the teaching case for social entrepreneurship and explains why faculty should start offering courses now. Building on a systematic review of curricular offerings published in the Ashoka U Curriculum and Teaching Resource Guide, the Institute asks questions such as: What is the current state of curricular offerings? And which best practices should we be considering? With senior faculty, it then reviews what are the key cases and themes that are taught in the best social entrepreneurship courses, and provides guidance how to build a great course using the most effective elements.

After a successful pilot, the plan is to now roll out the Faculty Institute. Initially, it will be made available to all members of an Ashoka University-led consortium comprising so-called "Changemaker Campuses", that is, universities committed to implementing a social entrepreneurship vision at all levels of the university's activities.

Case 3: Ashoka University Faculty Institute

Taking a structured approach to incubating social enterprises is a second channel to raise supply. By lowering the barriers through a support system, other social entrepreneurs and enterprises can emerge – in addition to the archetypical "crazy" social entrepreneur who was at odds with "the system" (and often the family as well) for a long period, but stayed the course and built a track record on social impact that ultimately led to his or her recognition. This second channel seeks to leverage social entrepreneurship talent through enabling structures.

This means setting up incubator organizations such as Heart, in South Africa, founded by Peter and Mandy Shrimpton (http://www.growsouthafrica.org/home/tabid/832/Default.aspx). The Shrimptons began their incubation work by establishing a hub for social entrepreneurs in Cape Town in 2004. Subsequently, they developed a methodology to incubate social enterprises and teach social entrepreneurs how to run sustainable businesses, covering areas such as asset management, venture capital, investor relations and corporate communications.

The key challenge in the incubation space is straightforward: how to be sufficiently business minded to ensure the sustainability of the incubator and the incubated organizations, but not so much so that the commitment to genuine social impact is abandoned? To stay on mission, incubators and portfolio entities both need to design and maintain incentive systems that reward aligned socially entrepreneurial behavior throughout an organizational pyramid and set boundaries on what not to do. This requires encoding a social vision in an organization in ways that subsequently permit its further development and expansion by deploying conventional management talent.[21]

Such a “synthetic social business” approach is simply another entry point to social entrepreneurship. It is based not so much on charismatic individuals who are supply-constrained, or social movements, but rather on enabling structures. In a narrow sense, a synthetic social business can be defined as a business venture whose social purpose is encoded in the holding structure of the company.[22] An incubator is especially well positioned to ensure that the organizational design reflects the social vision if the entity benefits from subsidized or free social entrepreneurship incubation services in its early stages. For example, a philanthropic foundation could hold a significant ownership stake and special voting rights with the mission to make the good or service available to as many people as possible around the world. The set-up then commits the company to pursue a “social” business development and market positioning strategy. It focuses on higher volumes and lower margins, or a tiered pricing strategy that renders the product or service available to wealthier and less favored parts of society alike, as in the case of Aravind. The entity is considered a “synthetic” social business, because the impulse to behave as a social business was intentionally built into the business model of the company and is less dependent on the individuals who have founded or lead the company.

To some extent, a synthetic social business can then be developed just like any other business, mainly by deploying management talent. Consider the case of TOMS shoes, a US footwear company which also operates a non-profit subsidiary, Friends of TOMS. Assuming that there are over one billion people at risk for soil-transmitted diseases around the world which could be prevented with shoes, the company has redesigned its value chain in such a way that for every pair of shoes bought, another pair of shoes is given to a child in need.[23]

The potential for insemination is enormous. In the field of technology, for example, with 185,000 patents issued by the US Patent and Trademark Office alone in 2008, developing just one per cent of them through the formula of synthetic social business and assuming that only one in every ten new ventures will succeed would nevertheless add another 20% capacity to the intrinsic social entrepreneurship pipeline every year, and thus help to further close the supply gap.[24] Or simply imagine the change potential unleashed once the first 100 universities around the world have rolled out a train-the-trainer Faculty Institute.

4. Revolution Two: From Microfinance to Inclusive Financial Services

Microfinance provides different forms of access to capital to low-income individuals or the "economically active poor", with the objective of economic empowerment and poverty alleviation. Microfinance refers to financial services at the bottom of the economic population pyramid that broaden access to capital. With a current market of US$ 25 billion, roughly 100 million borrowers, a potential demand of 500 million borrowers and a market size of US$ 250 billion, it is one of the frontiers of philanthropy in the decades ahead, and an enormous capital allocation and social impact opportunity. Microfinance is now transitioning from a focus on credit to inclusive financial services. In addition to microcredit, microfinance also includes micro-savings, micro-insurance, remittances and other financial innovations.

Critical debate about the social impacts and long-term financial viability of microfinance, especially in India, has recently reached mainstream media around the world. Many of the points made concerning specific organizations and their problems are correct and need to be taken into consideration when making investment decisions. However, in a fundamental sense, microfinance will remain a growth industry and an important social impact opportunity for many years to come. Approximately 2.5 billion people from low-income countries and many of the 2.7 billion people from middle-income countries remain underserved by the conventional financial services industry.[25]

Microfinance is an especially pertinent example of deploying market mechanisms for social change for two reasons. First, because the microfinance experience shows that the profit-motive and social impact do not necessarily conflict with one another. Second, because over the past three decades, the microfinance field has successfully gone through the different stages that the now emerging impact investing industry is likely to go through over a shorter period of time.

Microcredit portfolios share four characteristics:

- First, the target clients are low-income borrowers: typically, they are self-employed or owners of micro businesses in the informal sector, rather than salaried workers.
- Second, the average loan size is small and often much less than EUR 10,000 in Europe and Central Asia, and US$ 7,500 elsewhere.
- Third, while more expensive than the provision of credit to wealthier segments of the population, microfinance is much cheaper than the unsecured credit provided by the loan sharks that have traditionally served the informal sector. Moreover, it takes place in an institutionalized legal context rather than the context of organized crime and violence.
- Finally, microfinance uses alternative lending techniques. Operating with little or no conventional collateral, it deploys group lending and other techniques instead.

In a group lending model, individual members of a borrowing group can only access credit if the other members of the group meet their repayment obligations. This creates a strong degree of group-monitoring and lowers the due diligence and repayment enforcement costs for the lender. Group lending rolls over part of the risk to the group community and keeps costs at the level of the microfinance institution (MFI) down: most of the monitoring is done by client groups or villages, who may meet up to five times a week. Group lending is therefore generally considered to be more scalable than individual loans to the poor.

However, practitioners sometimes argue that the group-centric approach produces average rather than excellent empowerment outcomes: borrowing group members do not necessarily accept that one of the members is a more successful micro entrepreneur or has a better business idea, and therefore can and should deploy a much higher loan multiple (for example, 10x). From a control perspective, there are also risks resulting from the fact that the MFI does not know all of its clients individually, and has few means to assess phenomena such as over-indebtedness resulting from multiple loans from different MFIs active in a shared client franchise. There is general agreement that group lending is especially attractive where transaction costs are prohibitively high, as in rural areas.

As such, microfinance is not new. For example, the notion of group lending that is central to many microfinance business models and that of the pioneering Grameen Bank in Bangladesh is rooted in the nineteenth-century European credit cooperative movement and in particular in the work of Friedrich Wilhelm Raiffeisen.[26] Franciscan monks founded community-oriented pawnshops as early as the fifteenth century.[27] Group lending was already well established in Bangladesh when Muhammad Yunus began his lending experiments to the poor in 1976, which led to the establishment of the Grameen Bank in 1980.[28]

But as a global movement and an emergent asset class, microfinance is a recent phenomenon. Similar to the founders of Acción and BancoSol in Latin America in the 1970s, Muhammad Yunus made a difference because he found ways to *scale* microfinance, facilitating the emergence of a global movement which succeeded in turning microfinance into an investable proposition. In many ways, this is reminiscent of Dr. V's "McDonaldization" of eye care – in the field of loan finance.

Similar to the case of social entrepreneurship discussed in the previous section, the development of microfinance took time, evolved in stages, and entails lessons for other fields of philanthropy and impact investing. Over a thirty-year period, microfinance gradually became an industry and an asset class for investors. Today, it is particularly attractive to those who are interested in low-volatility investment opportunities and segments of the capital market uncorrelated with mainstream global benchmarks, and for investors who want to both "do good" and "do well" with a part of their asset portfolio.

But how did we get here? In the 1980s, microfinance was mainly seen as a highly effective tool for economic empowerment and poverty alleviation. The anecdotal life stories of the empowered individuals graduating from poverty took center stage. There was a sense that all that was missing was global scale. In the following decade, the microfinance industry grew. The financial profitability of banking for the poor came to the forefront. The pendulum began to swing toward the other end of the spectrum, viewing microfinance mainly as a commercial investment proposition. During the 2000s, microfinance started to be positioned as a veritable asset class for investors, evidenced by the fast growth of many investment funds, and downplaying its non-profit origins.

Notwithstanding, most microfinance institutions around the world have historically started as non-profits. Without grants and soft money, there would be no microfinance industry to speak of today. Over time, some institutions became financial institutions with shareholders. Eventually, the more successful players obtained full banking licenses dedicated to the needs of the unbanked and poorer population, and grew into the largest financial service providers in their region.

Consider the example of Banco Compartamos, a Mexican microfinance bank which currently serves 1.75 million clients, with a total active loan portfolio of Mexican Pesos 8,784 million (US$ 703 million) at the end of the third quarter 2010, and a return on average equity of 40.9%.[29]

When Banco Compartamos went public on the Mexican stock exchange in 2007 in a secondary offering of 30% of its shares, priced at US$ 468 million, it was already a highly profitable operation, making loans to the poor; but a long grant-funded development period from 1990-1998 preceded financial takeoff.

Banco Compartamos traces its origins to a microfinance initiative called Compartamos AC, a non-profit organization dedicated to social issues in Mexico launched in the poor areas of the states of Chiapas and Oaxaca. In the late nineties, Compartamos AC collaborated with Acción International, a U.S. non-profit organization focused on stimulating microfinance globally, in order to establish a commercial, regulated microfinance company in Mexico. In 2000, Compartamos received the respective license and established SOFOL Compartamos, a single purpose finance company devoted to microfinance. Now set up as a commercial enterprise rather than a grant-funded non-profit, Compartamos experienced amazing growth.

From 2001-2006, its portfolio of active clients grew at a compounded annual growth rate (CAGR) of 46%, and its loan portfolio in U.S. dollars even faster, at a CAGR of 60%. What was once a subsidy-funded operation had become highly profitable: 2001-2006 net income grew at a CAGR of 67%, ending 2006 with a return on equity (ROE) of 56%. In 2006, SOFOL Compartamos was finally granted a full banking license, becoming Banco Compartamos, and clearing the path for the initial public offering that would value the company at US$ 1.5 billion.

The profitability of Compartamos has since caused some controversy, raising questions as to what constitutes a "fair" profit when providing financial services to the poor. Grameen Bank founder Muhammad Yunus famously argued that he feared that microfinance had been twisted to benefit investors, rather than the poor: "When you discuss microcredit, don't bring Compartamos into it", – he stated – "microcredit was created to fight the money lender, not to become the money lender".[30] On the other hand, the continued fast growth of Compartamos, adding over 20% new clients over the past year, suggests that its clients consider the bank's financial products offering to provide an attractive cost-reward ratio.

Case 4: Banco Compartamos

Following the growth of microfinance institutions, a range of microfinance investment vehicles (MIVs) emerged. Development institutions and the consulting firms to whom they outsourced field project work were the first to discover the financial potential of micro-banking. Credit turned out to be a product that was relatively easy to replicate and adapt. Unlike other development projects, micro-banking projects could lead to solvent and sustainable businesses. Properly run, a microfinance institution (MFI) manages a highly diversified client pool and a revenue stream with many thousand payments every week. And the smaller the business, the larger the potential for economies of scale and the higher the margin: a micro-entrepreneur with sales revenues of two US dollars a day who is working on fixed costs of 50 to 100 cents is a representative example. Production and sales can often easily be doubled or tripled by lending a few hundred US dollars for working capital or fixed assets. However, making loans of such small size is very costly and labor intensive. Making the numbers work requires attention to operating efficiency.

Over time, public sector seed investors succeeded in attracting interest from the private sector. To invest in microfinance institutions, the first ever for-profit investment fund was set up in 1998 and distributed through private banks in Geneva, Switzerland. In the early 2000s, many specialized fund management boutiques and fund advisers emerged. Ten years later, investors had a choice between a wide variety of microfinance investment funds offered both by specialized boutiques and global banks. In 2009, there were over one hundred microfinance investment vehicles. Their growth has by and large not been adversely affected by the financial crisis. According to the CGAP (Consultative Group to Assist the Poor, World Bank) 2009 survey, MIV assets grew to over US$ 6.6 billion in a decade.[31] Investors include asset managers, socially responsible investments (SRI) funds, family offices, retail clients and institutional investors such as pension funds. Well-known brands include BlueOrchard Finance and Symbiotics in Geneva, responsAbility Social Investment Services in Zurich, Triple Jump in the Netherlands, MicroVest in Washington, and Developing World Markets in New York. Building tailored products for specific groups of investors, the specialized boutiques are the most common point of investment entry for international private investors in microfinance today.

Getting the further scaling of what is already a big market right will be the challenge ahead. The future of microfinance consists of a broader shift toward inclusive financial systems. The 2009 Micro-Credit Survey acknowledges over 3,552 microfinance institutions reporting over 154 million micro-enterprise clients worldwide, of which over 106 million are among the poorest.[32] While the Micro-Credit Survey does not survey all of the financial services for the poor worldwide, it gives a good overview of the sector. Assuming an average loan of US$ 500-1000, the current market size is at US$ 75-150 billion, suggesting a 30% annual growth of the industry over the past ten years, when market size was estimated at US$ 15-30 billion. However, the underlying market demand is much bigger. Estimates indicate that there are at least 500 million micro-entrepreneurs worldwide. Each would require on average at least US$ 500 per annum to sustain their family and activities, yielding a target market of at least US$ 250 billion. About 10%-20% of market demand is currently being met. From an investment perspective, about 250 MFIs around the world are currently commercially self-sustainable and interesting targets for foreign investors. India in particular is a "hot" MFI theatre and has recently shown signs of client over-indebtedness and excessive expansion. Pre-financial crisis, the balance sheets of many MFIs were growing at an average rate of 25%-50% per annum. Most of these institutions capture savings locally and are at least partially owned by local investors.

As the decade unfolds, we can expect a further development of the microfinance industry along the following three vectors. Together, they will complete the industry's shift from microfinance to inclusive financial services.

Corporate social responsibility. First, the mainstreaming of microfinance means increasing attention to the corporate social responsibility of MFIs. Codes of conduct for all stakeholders in the value chain will become more central, and in some cases required by MIVs. For example, Symbiotics, a leading Geneva-based microfinance investment platform that serves as portfolio manager or advisor to 20 microfinance funds and syndicates debt, has pioneered a social responsibility rating that is taken into account when making investment decisions. The Symbiotics screening examines the following seven dimensions: social governance; labor climate; contribution to financial inclusion; fair treatment of clients; diversity and quality of products; social responsibility towards the community; and environmental policy.[33]

Segment development. Second, as MFIs look for opportunities to grow their business, they will gradually cover all segments of the unbanked: micro, small, and medium entrepreneurs. Policy making entities in microfinance, such as CGAP, have therefore broadened the scope and array of microfinance, its definition and constituents and shifted from microcredit to microfinance, and now to the concept of "inclusive financial services". In an income pyramid, this expansion can also be referred to as "vertical growth". Additional income segments of the economically active unbanked and their businesses are gradually being integrated "vertically" into the financial services market, gradually comprising micro, small and medium income. The range expands both toward those who are vulnerable but not poor, and those who are extremely poor. Building inclusive financial services renders the industry more heterogeneous. It means that microfinance investors can now pursue segments as diverse as small village banking non-profit MFIs and small and medium enterprise (SME) finance commercial banks. Moreover, microfinance institutions are now also present in the industrialized world (e.g. Street UK).

Product offering. A third industry trend is similarly a consequence of microfinance institutions' quest for scale. Following the evolving financial product needs of the micro, small and medium entrepreneurs to improve their living standards, MFIs have already moved from microcredit into micro-savings, micro insurance, and micro-remittances. Referred to as "horizontal growth", many providers of microfinance now transition away from a single product offering such as micro-enterprise loans. They adopt a general offering framework of inclusive financial services. The goal is to cover a full range of daily needs and corresponding micro-capital requirements: housing, energy, utilities, insurance, and so on. The 2010s will see further product development providing access to capital to finance needs as diverse as education, energy, food, health, housing, water and sanitation, among others. Moreover, more and more microfinance institutions outside of the Latin American and South Asian regions where the current microfinance model took off first now regionalize and globalize.

Over time, investors will face more choice and opportunities in each of the five possible pathways to investing in microfinance: direct equity, specialized funds, lending and guarantee schemes, investment banking and structured products, and IT-based peer-to-peer investment. Let us quickly review them.

First, in the case of **direct equity**, investors can engage in direct equity investments in MFIs and retail banks. A few networks also build micro-banks from the bottom up, using foreign capital from international financial institutions as seed money. Traditionally, these networks have not been for-profit, but private equity funds have been created as well. ProCredit Holding is the single most important case of a joint public-private initiative of bottom-up building of microfinance institutions, with public sector investors including the International Finance Corporation and the Dutch and German development agencies, which jointly hold just above 50% of voting shares. The number and volume of direct equity opportunities is bound to increase also because more and more local commercial banks have elected to downscale their operations to reach the lowest income segments of their national populations by building microfinance operations. For example, ICICI Bank in India is downscaling through partnership models with non-profit organizations. In Latin America, the downscaling approach is widespread so that micro-banks often compete with commercial banks. The largest micro-credit program worldwide, Bank Rakyat Indonesia (BRI), with several million micro-enterprise clients, is also one of the largest banks in the country. In Eastern Europe, the European Bank for Reconstruction and Development (EBRD) has helped many banks to downscale. The equity of banks who are downscaling is often more accessible for international investors than MFI equity.

Second, in the case of **fund investments**, investors face an increasing array of choice as well. Today, investors can invest in a variety of microfinance investment funds, offered both by specialized boutiques and global banks. Some global banks also offer microfinance funds. They either internalize the specialized management function, such as Deutsche Bank, or externalize it, as Credit Suisse has done by teaming up with responsAbility Social Investments, or Dexia Bank which teamed up with BlueOrchard Finance. These funds benefit from the banks' distribution franchise. At some point, microfinance will become such a mainstream investment product that most banks will offer it to their clients. Ultra high net worth individuals have played a key role in this mainstreaming process, showcasing client demand and offering solution templates through their own closed-end funds. For example, Pierre Omidyar, the founder of eBay, has committed over US$ 100 million to microfinance through his Omidyar Network Fund and the Omidyar Tufts Microfinance Fund. Robert Patillo, a US real estate entrepreneur, launched a fund through Gray Ghost in 2006.

Wholesale lending and guarantee schemes constitute a third pathway to microfinance which is set for growth. Investors can also commit capital to banks for on-lending or the issuance of guarantees. For example, US-based Minlam Asset Management LLC is a microfinance investment management firm that creates and manages wholesale financial products to address the increasing number of commercial opportunities in microfinance and provides microfinance institutions with customized local currency funding. Moreover, global commercial banks have also chosen to attract deposits from investors and on-lend to borrowers. Guarantee products are another way to unlock capital and are likely to become a part of the mainstream as the microfinance industry matures further. The International Guarantee Fund in Geneva is the pioneer in this intermediation model. It delivers a stand-by letter of credit to local banks, which then on-lend to MFIs with leverage. Today most microfinance investment vehicles use this model to mitigate country and currency risk. The guarantee scheme has also been used by ultra high net worth individuals: they pledge a part of their own investment portfolio as collateral to a microfinance investment. The Grameen Foundation set up a Growth Guarantee Fund with Citibank which sells off risk to this group of investors.

Fourth, there will be increasing opportunities to invest in MFIs through **investment banking transactions**. As MFIs mature, they become increasingly eligible for raising capital through investment banking transactions, e.g. issuing bond obligations and micro-credit securitizations. Local investment banks have started to assist the more mature MFIs issue their own bond obligations on the local capital markets. Major investment banks have built significant expertise in this area over the years, and it is starting to become an interesting business. Citibank has been very active, most notably on the Compartamos bond issues in Mexico since 2001 rated by S&P, or on selling the securitization notes of Bangladesh Rural Advancement Committee (BRAC), the world's largest non-governmental development organization with over 7 million microfinance members covering all administrative districts of Bangladesh. Deutsche Bank arranged the first true sale securitization of micro-credit and SME loans for ProCredit in Bulgaria in 2006. As more and more MFIs mature and become commercial banks, many will turn to local capital markets to raise capital, becoming logical clients of investment banks. Bond obligations and securitization notes, in turn, constitute entry points for local investors, and in some cases for offshore microfinance investment vehicles. Structured credit derivatives finance is bringing additional opportunities to microfinance, allowing controlling, segregating and managing the specific risks of microfinance investments. Global investment banks have begun to structure collateralized debt obligations (CDOs) for microfinance. JPMorgan Securities placed over US$ 50 million of the US Government OPIC notes to fund the first microfinance collateralized loan obligation. Finca International, a US-based microfinance organization, created a $21.2 million CDO with the help of Deutsche Bank. Its affiliates in places such as the Democratic Republic of Congo and Azerbaijan seek to leverage that money up another five times before lending it out in US$ 500 installments to tiny start-ups and would-be entrepreneurs.[34] Boutiques such as BlueOrchard, Developing World Markets and Symbiotics have arranged and placed offshore CDOs, arranging issuances of over US$ 50 million of notes.

Retail IT platforms. Finally, microfinance is developing an increasingly strong appeal to retail investors who want to do good with a part of their financial assets. Responding to this preference, peer-to-peer investment platforms such as Kiva or MyC4 are driving down transaction cost in micro-lending and creating direct access on the sell side.[35] For example, Kiva, a non-profit from Silicon Valley founded in 2005, initially offered individuals to elect individual micro-entrepreneurs they would like to support through their Internet platform, and then allocated capital made available by its users through Paypal. To ensure quality control, Kiva has since changed its methodology and now works through a network of approved field partners who post profiles of qualified local entrepreneurs on the www.kiva.org website. Lenders subsequently browse and select a micro-entrepreneur they wish to fund, and Kiva then aggregates loan capital from individual lenders, which is transferred to the respective field partner for disbursement. Web-based retail lending platforms are multiplying in Europe as well. Take for example MyC4, a Danish platform created in 2005. So far, over eighteen thousand investors from over 100 countries have invested more than EUR 12 million in over 6,000 businesses in seven African countries through its platform.

Overall, structural microfinance industry change and increasingly sophisticated investment tools to allocate capital efficiently and price risk will give the sector more and more of a business rather than a philanthropy feel. When Muhammad Yunus and the Grameen Bank received the Nobel Peace Prize in 2006, there was still a widespread sense that microfinance was a panacea to succeed where classical development interventions failed. Since then, the pendulum has swung into the opposite direction. Criticism of the industry has grown. Examples in India and elsewhere have shown how counterproductive an overheating microfinance market with excessive liquidity and competition can be to the stated goal of economic empowerment and poverty alleviation.

As the decade unfolds, we can expect the social impact of microfinance to be assessed in an increasingly realistic fashion. Far from a magic solution to poverty, microfinance can nevertheless be an extremely powerful tool to enable the economically active poor to raise their daily living standards and graduate from poverty over time.

Access to capital plays a key role in development. The success of further scaling microfinance to reach its full potential to finance meaningful social change at the grassroots level will therefore be one of the determining factors of the success of global philanthropy in the first half of the twenty-first century. Given the remaining pent-up demand for capital among the poor, and the noticeable emergence of a veritable industry with the corresponding skill sets and an expanding product shelf, microfinance investments should continue to see amazing growth in the decades ahead. Gradually, they will fulfill the ambition of inclusive financial services around the world. It is in this light that the current debate about the limitations and misapplication of microfinance is best viewed as a learning opportunity on what to do better.

5. Revolution Three: From Development Assistance to Base-of-the-Pyramid Investments

Next to social entrepreneurship and microfinance, global philanthropy's third revolution consists of the implications of the recent re-conceptualization of the Third World or developing world as the so-called "base of the pyramid" (BoP). BoP refers to a gigantic market with four billion people and pent-up demand for a whole range of goods and services in areas such as education, health, housing and sanitation.[36] Viewed against the background of a general move away from top-down classical development interventions toward more bottom-up or industry-focused entrepreneurial investment approaches, global philanthropy plays an important role in obtaining balance between social impact and profits.

In 1970, the wealthy member countries of the Organization for Economic Cooperation and Development (OECD) agreed to the United Nations Resolution 2626 which set the target of giving 0.7% of their gross national product as overseas development assistance (ODA) to developing countries.[37] Most of the countries have not reached the agreed percentage over the past 40 years. Jointly they have nevertheless given a staggering US$ 2.98 trillion in aid since 1970.[38]

Notwithstanding, poverty and underdevelopment persist in many countries around the world. Some critics therefore focus on the shortfall in volumes. They argue that annual overseas development assistance of currently approximately US$ 190 billion, which is roughly the same amount of money as the nominal GDP of Egypt in 2009, has been insufficient. Others criticize development assistance in fundamental ways, questioning its effectiveness in achieving development.[39] Finally, a further radical view has emerged that argues that development assistance is not merely ineffective, but, even worse, perpetuates underdevelopment and is therefore downright harmful. Articulated first in social science circles in the 1990s, in books such as *The Anti-Politics Machine* (1994) and *Encountering Development* (1995), this third view has recently gained more traction, in particular after the attention generated by the book *Dead Aid* (2009). Written by a former Goldman Sachs employee, Dambisa Moyo, the book assesses the impact of 1 trillion US dollars given in development assistance to Africa over the past fifty years. The author argues that aid hinders rather than stimulates development, and calls for ending development assistance to Africa within the next five years.[40]

The deconstruction of the development assistance paradigm and the implications for philanthropy need to be understood in the context of a fundamental mindset change concerning the role of markets and business in attaining socio-economic development.[41] Since the 1980s, the problem of underdevelopment started to be reconsidered in terms of opportunity and business, as the now widely adopted term "emerging markets" suggests. Originally coined by World Bank economist Antoine van Agtmael, it has partially substituted earlier concepts such as "Third World" or "developing countries".[42]

The conceptual shift has implications for global philanthropy. Development assistance is increasingly questioned as problematic. Transaction costs are often assumed to be even higher than in the social capital market, whereas market-based investment solutions are instead seen as a more effective way forward. What does this mean, seen that global philanthropy has been involved in development work for decades?

Take for example the Green Revolution, a term first used in 1968 by USAID director William Gaud. It commonly refers to the massive increase in agricultural productivity that took place in Asia in the late 1960s, and is widely credited to work done by agronomist Norman Borlaug, who received the Nobel Peace Prize for his work in 1970.[43]

But despite popular perception, the Green Revolution neither started in the 1960s in Asia, nor did it end in that decade. The roots of the "revolution" were in a Rockefeller Foundation funded agricultural research program to boost wheat yields in Mexico.

In 1943 Mexico imported half its wheat. Recognizing the problem, the Rockefeller Foundation established a pioneering technical assistance program, under which Borlaug worked to improve wheat production and cultivation in Mexico for over a decade and helped train a new generation of Mexican scientists. As a result of that program, Mexico became self-sufficient in wheat production by 1956 and was a net wheat exporter by 1964.

Case 5: The Rockefeller Foundation and the Green Revolution

Shifting from development assistance to base-of-the-pyramid investing is based on the premise that a joint deployment of capital, professional expertise, technology and the local presence of a commercial investor with a global network can unlock significant economic and social benefits.

The units of analysis are no longer specific countries, but individuals: the consumers. They have so far accessed goods and services at a significant disadvantage, both as consumers of basic goods and services, and as producers within some value chain, accessing e.g. credit, equipment or logistics.

Global philanthropy has become involved in the mainstreaming of BoP investing, and this trend can be expected to continue. It is a direct consequence of the success of microfinance in providing capital to the economically active poor and their micro-businesses, as discussed in the previous section. Microfinance has demonstrated that market mechanisms can provide social and economic benefits to individuals in the lower income strata around the world, as well as attractive financial returns to investors. However, microfinance focuses on the economically active poor who often operate in the informal sector. It can therefore only provide a partial solution to address the pent-up demand among the poor for health, education, and basic goods and services, which require a formal sector supply-side response in scale. Similar to microfinance, base-of-the-pyramid investing is bound to transform the boundaries and methodology of global philanthropy, and will provide new answers as well as raising uncomfortable questions in the process.

"Fair" levels of profit taking will be one question. Given the massive scale of unmet needs and the aggregate purchasing power of the poor, base-of-the pyramid markets can be expected to provide significant wealth creation opportunities for investors. These markets display several characteristics that cause and perpetuate disadvantaged access for the poor. Global philanthropy's involvement should be assessed in terms of its contribution to removing these barriers. Key factors include: entry barriers, lack of information, imperfect competition, insufficient vesting of property rights, as well as high search, transaction and switching costs.

As a result, business value propositions that serve the poor are often suboptimal. Poor consumers typically pay a "poverty premium". Prices for the goods and services they consume are often substantially higher than in conventional markets. This provides an opportunity for innovative investors willing to provide alternative, better value propositions. Those who can overcome the structural hurdles to provide affordable goods and services in scale can both reap substantial profits and economically empower the poor. As some of these investments mature and the magnitudes of realistic financial returns become clearer, this will add another angle to the question of what would be a fair profit when serving the poor through a market-based solution.

A second question will relate to the proper role of philanthropy in base-of-the-pyramid investing. Global philanthropy increasingly recognizes that small, medium and large enterprises with adapted value propositions for the BoP target segment will play a key role in meeting demand in the next decades. But the development of such firms is hampered in most of the developing economies by the under-provision of risk capital for small to mid-cap enterprises.

One role for global philanthropy is the provision of such risk capital. As the impact investing industry matures, the scale of the impact is likely to be consequential. The JPMorgan report mentioned in section 1 estimates the following BoP investment capital requirement over the next ten years in five key sectors:

- Housing: Affordable urban housing US$ 214 - US$ 786 billion
- Water: Clean water for rural communities US$ 5.4 - US$ 13 billion
- Health: Maternal health only US$ 0.4 - US$ 2 billion
- Education: Primary education US$ 4.8 - US$ 10 billion
- Financial Services: Microfinance US$ 176 billion

We currently still witness the early days of BoP investing; development assistance continues to be the mainstream. Over time investments at the base of the pyramid are nevertheless likely to become another emergent asset class that will draw interest from commercial capital market players.

The rate of change seems to be faster than in the history of the microfinance industry. Analogous to the developments discussed in the previous section, where microfinance investment vehicles began to emerge in the late nineties, dedicated BoP investment vehicles (BIVs) were beginning to be created ten years later. Similar to the MIVs which would have had no portfolio MFIs to invest in if there had not been philanthropic money and development assistance to get them off the ground, different forms of grant funding of portfolio companies at some point in their lifecycle are similarly essential to BIVs. As a rule of thumb, proof of concept needs grant money, whereas scaling up requires commercial money.

There is an increasing recognition among philanthropic and multilateral actors that grants cannot do the job in isolation from investment capital. Without facilitation, investment capital is often unwilling to go into the riskier or less conventional markets where the need is greatest, namely sub-Saharan Africa and developing countries that do not have large domestic markets or are not yet middle-income economies. BIVs therefore often operate in partnership or with the assistance of philanthropically-minded or multilateral players. The latter want to draw commercial capital into the development equation and are happy to establish joint capital pools. The original grant pool can be enlarged via investment arrangements that combine investors and philanthropists into consortia or funds. This requires taking into consideration their different risk tolerance, return objectives, and expertise sets. Going forward, the joint capital pool approach, where philanthropic organizations and businesses collaborate to jointly develop a solution that neither of them could orchestrate on their own, will become much more widespread.

To illustrate this trend, consider two examples. First, let us look at the field of public health in Africa. Healthcare in sub-Saharan Africa is characterized by substantial access shortages for low-income populations, quality shortfalls, and excessive cost. The list of challenges is long. It includes a shortage of physicians, nurses and other health workers, too few and overcrowded public facilities, a sense of low quality care in public hospitals and clinics, management and medical training gaps in health facilities, and compulsory fee-for-service payments at most public facilities, irrespective of income level. To access even public care, gatekeepers frequently impose side payments upon everyone, including the poor. Moreover, insurance schemes are insufficient, and a majority of healthcare expenditures are private and often funded out of pocket. While Africans need affordable and accessible quality health care, the public sector has neither the resources nor the expertise to provide a full-scale solution. A hallmark IFC study, *The Business of Health in Africa*, finds that 60% of healthcare financing in Africa comes from private sources and about 50% of total health expenditure goes to private providers.[44]

Given the limitations inherent in public sector and donor-led approaches, innovative donors consider an investment approach promising for three reasons: (1) there is already substantial demand for private sector health care; (2) there are profitable private sector business models which could be scaled; and (3) the healthcare sector is currently underserved by investment capital. However, simply throwing investment capital at the issue is unlikely to yield the intended results. Success requires mobilizing serious expertise in healthcare financing, healthcare training, medical and pharmaceutical manufacturing, and telemedicine, paired with the ability to mobilize production facilities, distribution systems and networks to reach underserved and low-income groups.

Based on this view, the International Finance Corporation (IFC), the African Development Bank (ADB), Deutsche Investitions- und Entwicklungsgesellschaft (DEG) and the Bill and Melinda Gates Foundation (BMGF) decided in 2007 to develop a commercial for-profit investment vehicle focusing on health in Africa. The objective was to enable low-income Africans to gain increased access to affordable quality health services by backing healthcare companies in sub-Saharan Africa and helping them scale and professionalize their operations, while also providing investors with attractive long-term financial returns.

After an initial feasibility study and an extended deliberation period, the sponsors decided to create a dedicated Africa Health Fund, to be managed by Aureos Capital, a UK-based private equity fund management company set up in 2001. Aureos specializes in investing in small to medium-sized businesses in emerging markets through multiple funds. Originally set up by CDC, the UK Government's Development Finance Institution, Aureos was bought out by its management in 2005. Fund investors are CDC, Norfund, FMO, and over 70 other institutional investors including international finance institutions, commercial banks, pension funds, fund-of-funds, high net worth individuals, family offices and foundations.

After more than three years of gestation, the Africa Health Fund was launched in June 2009 with initial commitments of US$ 57 million and a specified target to raise a total of US$ 100 million, with a final close in 2010. Fund investments focus on opportunities to increase the efficiency of the African health market. In June 2009, the Fund made its first investment. It acquired a stake in the Nairobi Women's Hospital (NWH) in Kenya for US$ 2.66 million. NWH provides health care services for women and children, focusing on providing inpatient, outpatient and specialized services for women, including antenatal, gynecology, obstetrics, breast cancer detection and surgery, and operates East Africa's first Gender Violence Recovery Center. According to Aureos, the investment in NWH will help fund a management buyout and the expansion of facilities such as clinics, beds, ambulances and operating theatres in East Africa. Davinder Sikand, Regional Managing Partner of Aureos in Africa, argues: "The provision of capital to SMEs operating in the health sector in conjunction with professional private equity support will certainly increase the efficiency of the African health market. This will benefit sections of the population that previously had asymmetrical or no access to vital healthcare".[45]

Case 6: Africa Health Fund

The Africa Health Fund is an experiment with a lot of potential; as the outcomes in terms of social and financial returns materialize over time, it will become clear whether it can serve as blueprint for other regions and sectors. The BoP investment approach is much more bottom-up than the development assistance framework that seeks to lift entire countries out of poverty.

Rather than pursuing a grand scheme, it is ultimately about increasing the efficiency of companies and industries, gearing them to provide affordable yet quality goods and services to the poor, and thereby achieving positive social impact. Moreover, BoP investing can also unlock value in middle-income economies. Consider the example of Ignia Ventures, a venture capital investment firm based in Monterrey, Mexico.[46]

Ignia focuses on the base of the pyramid in Latin America, defined as 360 million out of the region's 550 million people who earn less than US$ 3,000 per year. Aggregating their purchasing power, the market is estimated at US$ 510 billion, of which US$ 130 billion in Mexico alone, and roughly covering 70% of the population. Ignia models its understanding of the needs of BoP clients based on the principals' experience in microfinance in Latin America, which was gathered through their involvement in the establishment of Banco Compartamos and other MFIs. The fund was set up to apply this expertise to BoP sectors outside the microfinance sector, including basic utilities, education, healthcare and housing. To provide effective responses to the enormously underserved needs of low income populations, both as consumers as well as active participants in productive value chains, Ignia raised a US$ 95 million venture fund that seeks to empower entrepreneurship, generate social impact, and create attractive financial returns for its investors. To create value for its investors, Ignia follows a buy-and-build strategy. It looks for 25%-100% equity stakes that support the founding and expansion of high-growth social enterprises that serve the base of the socio-economic pyramid in Latin America. The fund seeks to invest in common or preferred stock of companies, in some cases structuring its investments as subordinated debt with warrants or convertible debt, in the range from US$ 2 million to US$ 11 million per company, typically in staged disbursements.

Ignia's investment thesis is based on three components.[47] First, the fund looks for innovative business models that serve BoP markets in ways that are scalable, operate a cash business, and are located in the "last mile" of the value chain. Second, the fund seeks to finance opportunities for scale by investing in: skilled entrepreneurs with a significant ambition and strong business vision; companies that count on experienced management professionals; and companies with a strong potential for execution of growth and scaling. Third, its investments must contribute to fundamental systems change and create social impact by delivering a good or service that makes an empirically verifiable positive impact on the capacity of BoP clients to accumulate assets, increase their income and improve the quality of their daily lives. At a structural level, investees are expected to generate substantial economic value to fund expansion on a massive scale and attract new industry entrants to the BoP segment. One of the fund's first investments was Primedic, formerly known as Transparencia Médica, a provider of healthcare services in Monterrey, Mexico, that operated three clinics and one radiological imaging facility in 2009.[48] Primedic provides access to unlimited primary health care and selected medical technology services and specialists through an innovative membership program which is affordable to urban individuals and families who earn less than US$ 3,500 per person per year.

Case 7: Ignia Ventures

In the Mexican context, this is a promising contribution which highlights how complementary entrepreneurial and classical "development" approaches can be. The Mexican government is aiming for universal health coverage by 2011 by further expanding Seguro Popular. A government medical insurance program designed for low-income individuals in unemployment or the informal sector, Seguro Popular has been successful in increasing coverage by about 25% of the population since 2004.[49] But near universal government medical coverage notwithstanding, 54% of the country's health spending was out-of-pocket in 2008, representing a US$ 27 billion market. This level of out-of-pocket spending results from the de facto high transaction costs the "free" government medical insurance imposes. There are many drivers: long lead times due to inability to set up appointments, transportation costs due to lack of facilities proximity, and on-site delays that negatively impact economically active individuals. The Ignia experience suggests that business solutions can indeed play a meaningful role in complementing more traditional development and social policy approaches, as well as grant-based philanthropy.

A key to the contribution BIVs will make to global philanthropy's social impact agenda will be achieving the right balance between profits and impact. Although the BoP investment vehicles have the feel of venture capital and private equity funds to them, philanthropy nevertheless plays a catalytic role in facilitating their emergence, and can help shape their social impact agenda. There are three reasons.

Risk absorption. First, on a stand-alone basis, commercial investors would judge BoP investment opportunities purely on the basis of risk-adjusted financial returns; as a result, many investments that are both profitable and have a high social impact would not pass the hurdle rate. This assigns an important enabling role to philanthropic capital. For example, a charitable foundation may be willing to provide subordinated debt at a relatively low interest rate to a commercial investment vehicle that invests in such healthcare companies, whereas a purely commercially minded investor will contribute funds for equity investments in target companies based on risk-adjusted return considerations and the realization that part of the risk has already been absorbed by the other types of capital providers.

Social impact. Second, by remaining engaged, global philanthropy can precisely help to ensure that BoP investments deliver both social and economic returns. Global philanthropy thus plays a crucial role with respect to standard-setting in terms of reporting and social impact measurement. Take for example the Global Impact Investing Network which was mentioned above, which seeks to accomplish standard-setting via its initiative on impact reporting and investing standards (IRIS).[50] In some cases, this may imply influencing business strategy choices at the portfolio company level. For example, philanthropic investors may be inclined to provide additional grant funding to a technical assistance facility to assist portfolio companies in developing product and service delivery channels that specifically target the poor.

More for mission. Finally, as impact investments, BoP investment vehicles can represent an excellent way for philanthropies to invest a portion of their endowments in direct support of their charitable mission while also achieving a financial return.

6. Revolution Four: From Classical Grantmaking to Entrepreneurial Internalization of Externalities

Grants remain today's core business of philanthropy: many of the fundamental challenges humanity faces in the twenty-first century cannot be tackled by markets alone. Free markets do not internalize externalities such as environmental destruction or negative public health impacts on populations that are not working in the formal sector. To address these and other challenges, private or public subsidies are required. In some cases, subsidies can and should be temporary, and directed toward establishing functioning market places. In other cases, concerning pure public goods such as, say, human rights, subsidies are required on a permanent basis to achieve the social objective in question. Grants will continue to play an important role in philanthropy, but increasingly be deployed to reward impact in public-private-civil society value chains.

The three revolutions under way in global philanthropy discussed previously all involved the combination of business methods and markets with philanthropic objectives focusing on the public good. Social entrepreneurship, microfinance, and base-of-the-pyramid investing are all important trends that will transform the way future generations will think about and conduct philanthropy.

In the 2010s, the fourth imminent revolution is the grant-based entrepreneurial internalization of externalities. This means using capital markets to monetize grant commitments in one of three cases:

- Whenever addressing a problem now is cheaper than addressing it in the future when a grant commitment is actually paid out;
- When new market places need to be constructed, or
- When the most efficient solution provider is not a government agency.

To illustrate this point, consider the fourth United Nations Millennium Development Goal (MDG): the reduction of the mortality rate of children under age five by two thirds by 2015. Immunization programs are a key element of a strategy to achieve this MDG, yet successful and comprehensive immunization remains a challenge. The World Health Organization (WHO) estimates that 24 million infants were not reached by the DTP3 vaccine in 2003 and are not vaccinated against common childhood diseases including diphtheria, tetanus, hepatitis B, yellow fever, measles and polio.[51] The previous year, an estimated 2.1 million people around the world died of vaccine preventable diseases, including two million children under the age of five. Many more fall sick, miss school and become part of the vicious cycle that links poor health to continued poverty in adulthood.

Immunization is a clear example where prevention through vaccines is much cheaper than treatment of disease. To address the needs for vaccines and immunization in the world's poorest countries with a per capita gross national income of less than US$ 1,000, the GAVI Alliance was created in 1999 with an initial grant from the Bill and Melinda Gates Foundation. GAVI is a public-private partnership between multiple agencies (WHO, UNICEF, the World Bank, industry representatives, the GAVI Fund, and donor and recipient governments). It channels funding to support the introduction of new vaccines as well as immunization programs for existing but underused vaccines. The scale of GAVI's buying and distribution power enables it to secure much lower prices for vaccines, which are then supplied to poor nations at a fraction of their cost. Other areas of activity include strengthening health systems, infrastructure, and education. GAVI has implemented an innovative performance-based grants program that rewards countries for increasing immunization coverage. Since 2000 it has committed more than US$ 1.6 billion to more than 70 of the world's poorest countries. GAVI's first 10 years are credited with having helped avert five million future deaths with GAVI-funded vaccines reaching more than 250 million children in the poorest parts of the world.[52] Notwithstanding, overall funding remains insufficient to provide complete coverage to the world's poor, and most countries are expected not to meet this or other key MDGs, unless new funding becomes available. Over the period up to 2015, the Alliance has an estimated funding gap of US$ 3 billion out of the estimated US$ 8.1 billion total funding needed.[53] In March 2010, GAVI announced it had almost completed a large-scale campaign to supply so-called pentavalent, or five-in-one, vaccines that address a range of preventable diseases including hepatitis B, diphtheria, tetanus, whooping cough and Hib in developing countries. "With US$ 7 billion, (GAVI) will be able to fully roll out pentavalent vaccine and introduce new vaccines against pneumococcal disease and rotavirus diarrhea in over 40 countries", GAVI stated. "These last two vaccines alone can save one million children by 2015".[54]

Case 8: The GAVI Alliance

GAVI is relevant not just because of the scale of its work, but also for the innovative use of financing mechanisms. To lower the total cost of achieving the MDG in a context of finite resources, using the tools of financial engineering provided the way forward: by borrowing against future government grant pledges, the GAVI Alliance was able to conduct immunization on a larger scale than current resources permitted *prior* to the actual receipt of the pledged funds. Given the intertemporal benefits and significant externalities creating positive economic knock-on effects, this created a win-win situation. Let us unpack this. To address the funding gap, the International Finance Facility for Immunisation (IFFIm) was proposed in 2004 as an independent development institution to generate finances to support GAVI's immunization programs. Formally established in 2006 as a charity registered with the Charity Commission for England and Wales, the IFFIm has the goal to generate up to US$ 4 billion for programs from 2006 to 2015. It provides funding to the GAVI Fund Affiliate, likewise a registered charity tasked with disbursing proceeds in support of approved GAVI programs. GAVI is responsible for the operational activities related to the immunization and/or vaccine procurement programs for which IFFIm funding is provided.

The IFFIm operates by raising capital from the international capital markets by borrowing against future grant pledges. At establishment, France, Italy, Norway, Spain, Sweden and the UK each provided binding donor commitments to the IFFIm totaling US$ 4 billion, with Brazil and South Africa later committing additional funds.[55] Given the pledges of donor governments, and IFFIm's association with the World Bank, IFFIm can raise capital on commercial terms with an “AAA” credit rating. Over the course of 10 years, the IFFIm will raise up to US$ 4 billion depending on the needs of immunization programs in GAVI countries. Fundraising will be done through sale of bonds to retail and institutional investors through a variety of transactions ranging from larger, more liquid issues to smaller targeted bonds.

The WHO estimates that IFFIm’s resources could lead to the vaccination of more than 500 million people over the next ten years, with the objective of preventing the deaths of 5 million children and 5 million adults via the usage of new and under-utilized vaccines, targeted immunization campaigns and the strengthening of health and immunization services in GAVI’s target countries.

In November 2006, the IFFIm released its first bond issue (5 IFFIM 11, SWX), to raise US$ 1 billion through notes at 5% interest due on 14 November 2011. Interest is payable annually, and the notes received the highest credit rating (AAA) from all three major credit rating agencies (S&P, Moody’s, and Fitch). The issue was lead managed by Deutsche Bank and Goldman Sachs, with eight of the largest financial institutions as co-lead managers to the issue.

The release and successful closure of this issue allowed IFFIm to leverage donor commitments to “frontload” its portfolio by raising commercial capital against those donor pledges. The bond program to support GAVI is a significant innovation.

There is no reason why one cannot apply such innovative finance mechanisms to any grant-funded issue that involves externalities and intertemporal benefits, that is, where acting today is cheaper in real terms than acting later. And indeed, there are more and more examples of bond issues that fall into this category. Consider the IFC’s first microfinance bond, where IFC issues a bond aimed at increasing access to finance for poor and low-income entrepreneurs in developing countries.[56] Arranged by Daiwa Securities Group, the bond will raise up to US$ 300 million equivalent, an amount comparable to IFC’s annual microfinance program in recent years, be denominated in Australian dollars and have sales open to Japanese retail and institutional investors. Other examples include the World Bank’s AAA 2009 Green Bond with a four year maturity and two tranches of US$ 130 million and US$ 50 million, respectively; or the 2010 five-year NZD 150 million Fourth World Bank Green Bond, designed for Japanese Investors as an innovative way to help combat climate change through a high-quality bond investment (ISIN: XS0479886672).

The previous discussion shows that the entrepreneurial internalization of externalities is not merely an exercise in financial engineering for donor governments operating under budget constraints: wherever prevention today plus the cost of a capital markets borrowing operation against future commitments is cheaper than treatment in the future, it makes sense to monetize commitments as in the case of GAVI. In such cases, money deployed today creates disproportionally greater social impact than money deployed tomorrow.

But there is a second facet worth highlighting. Grants can also provide transformational solutions to a wide range of social issues by constructing new hybrid subsidy-marketplaces. Let us look at another example, equally derived from the Millennium Development Goals: the domain of sanitation. The Millennium Development Goals set a target of reducing by half the 2.6 billion people without sanitation by 2015. Lack of access to basic sanitation causes widespread waterborne diseases with significant adverse socio-economic implications. This affects people’s health, their environment and their ability to work, and has a negative impact on their community and the country’s economy. According to the World Health Organization, 1.87 million people die every year from diarrhea and other water related diseases, of which 80% are children between six months and five years of age.[57] Conservatively estimated, addressing this challenge requires at least US$ 10 billion every year. There are large externalities involved. Every US dollar spent on sanitation unlocks significant health and other benefits. Depending on world region and particular circumstance, one dollar spent yields a positive impact worth between US$ 3 and US$

34. Thus, a structure similar to the IFFIm could in principle be deployed at some point to finance the scaling of global sanitation solutions. But unlike in the case of vaccines, there is no organized marketplace yet. It needs to be built first, and engineered to have supply meet demand at a reasonable price.

To study and design market-based solutions for sanitation, the former Head of Ashoka's Social Financial Services unit, Arthur Wood, piloted the project of the World Sanitation Financing Facility (WSFF, http://www.sanitationfinance.org) in Geneva in 2009. The goal is getting money to the market of 2.6 billion people who do not have a toilet.[58]

By identifying the market for sanitation products and services, matching demand and supply and ensuring that essential public funding is optimally used to support innovation through a streamlined capital flow, WSFF seeks to respond to the challenge of accessing finance or business attention. It aims to find alternatives to the standard transaction-cost intensive fashion in which capital is allocated in the social capital market which was discussed earlier.

To achieve this, the World Sanitation Financing Facility positions itself as a convener and agenda-setter that brings together people to realize the opportunities of the sanitation market, develop infrastructure and provide access to finance for entrepreneurs and customers in need.

To render its insights actionable, the WSFF has defined three work streams. First, it provides a platform for participants to brainstorm and pool expertise to generate practical solutions for financing sanitation at scale. Second, it identifies the sanitation market and various business lines and models for commercial investment. This work stream seeks to uncover and understand the best ideas across geographies and market segments so that financial products can be designed to support these businesses, both locally and at scale. Finally, the WSFF assists in financial innovation and a streamlined capital flow from public funders or banks and corporations to entrepreneurs and 2.6 billion potential customers.

As of October 2009, approximately 30 organizations were represented in the WSFF, each committed to the objectives of the WSFF and recognizing that new thinking is required to contribute to the Millennium Development Goal target of halving the proportion of people without access to basic sanitation by 2015, and to achieving universal sanitation coverage. WSFF estimates the total sanitation market to be over US$ 80 billion over 10 years, unlocking an additional US$ 685 billion of social externalities.

Case 9: World Sanitation Financing Facility (WSFF)

In addition to frontloading grant funding through capital market operations as in the case of GAVI, or deploying grants to construct hybrid market places as in the case of WSFF, a third innovative use of grants consists of providing performance-based contingent returns.

This approach is especially attractive where more localized challenges rather than big global issues such as health or sanitation are addressed, as in the case of the Social Impact Bond mentioned earlier. Similar to the IFFIm and WSFF, the approach also consists of internalizing externalities through capital markets instruments. Let us examine this.

In addition to designing optimal financing mechanisms to capitalize intertemporal benefits and externalities, another twist are mechanisms that will ensure that the work is done by the most efficient provider of the solution required. This may not be the government, even in the event of a classic public good such as security. Consider the issue of prison re-offenders discussed in the introduction.[59] In the UK alone, 40,200 adults leave prison every year after they have served a custodial sentence of less than twelve months. Locking up people is costly. Prison places cost the UK tax-payer well over GBP 213 million a year; thus, one might think that efforts are undertaken to keep the re-offending rate in check. But, quite astonishingly, UK adults on short sentences have historically not received any formal support to help them to successfully reintegrate into their community. Reintegration often fails. Within two years of release 73% of the offenders go on to reoffend. The rate is a staggering 92% for those under the age of 21. The absence of funding for reintegration programs is not an isolated example; there is a pattern in UK government spending to focus on costly consequences rather than cheaper prevention in areas as diverse as healthcare, adult mental health, and school truancy and exclusion. Of GBP 92 billion health expenditure in England, only 3.7% is spent on preventative interventions. Alas, the picture is not much different in many other countries around the world.

Based on the assumption that, given its interventions, activities and experience with marginalized communities, the non-profit sector is in principle ideally positioned to respond to many of today's social challenges, provided it can finance itself more efficiently, Social Finance Ltd. was created in 2007 with the goal to transform the ability of the UK non-profit sector to respond to society's changing needs through access to a variety of investment instruments. The goal is to combine the needs of investors and the non-profit sector in their efforts to deploy and raise capital, and research social investment markets and opportunities.

Inspired by former Ashoka's Head of Social Finance Arthur Wood's initial work on contingent return models, Toby Eccles' investment banking expertise and dogged determination to simplify the model to a point where it can practically work and then staying the course of implementation, as well as the encouragement, financial support, guidance and door-opening by a group of wealthy individuals in the UK, Social Finance came into being.

One of Social Finance's key ideas is to raise capital through "Social Impact Bonds". In this model, private investors provide funds to non-profit organizations that deliver formal support on some issue where prevention costs less than treatment. Investors then receive success-based financial returns to the extent that the social impact targets are met or exceeded. In the case of prison re-offenders, this means that a significant drop in the re-offense rate would compensate the investors who have provided the risk capital for the support organizations that provide reintegration programs. As integration is cheaper than re-offense, this would be a win-win for the public sector as well, which saves on treatment measures such as incarceration. The Social Impact Bond model is appealing and is now on track for pilot implementation in the UK.

Case 10: Social Finance

Should the experiment be successful, there is no reason why the Social Impact Bond model that effectively creates a public-private-civil society value chain could not be applied to the entrepreneurial internalization of the externalities associated with a whole range of social issues in all countries where government and the political process are sufficiently competent and trusted to reallocate public subsidies based on social performance.

Given the state of public finances in the European Union and around the world, long-term demographic trends, as well as the inherent limitations to the risk-taking capability of the public sector, a window of opportunity has opened up for providing public goods through market-based solutions. Germany's federal social spending alone exceeds EUR 154 billion a year. Clearly, all welfare states need to find ways to deliver greater impact with the resources allocated – otherwise the next 60 years will simply not be fundable.

This requires creating incentives that reward excellence in public goods provision and continuous improvement and innovation. As the examples of the IFFIm, the World Sanitation Financing Facility and the Social Impact Bond demonstrate, important innovations are under way in grant finance. They typically combine public sector agencies, civil society organizations and private investors and philanthropists in a single value chain, where financial returns are contingent on a social outcome.

The pilots are being closely watched in the philanthropic community. The volumes which these solutions allocate are still minuscule in the global context of grant philanthropy. But they hold the promise of such tremendous efficiency gains that they could provide a disruptive impetus to the field of grantmaking in philanthropy over the next decade. Next to social entrepreneurship, microfinance, and base-of-the-pyramid investing, this grant-based entrepreneurial internalization of externalities is the fourth revolution under way in global philanthropy; it is the least advanced of the three, but potentially the most disruptive.

7. Conclusion: Where Are We Headed?

Thinking about global philanthropy as a field reminds us that the relevant parties are part of a broader historical process. Every generation thinks that it lives in times of great change and likes to give this change meaning through orienting frameworks such as the four revolutions presented here. In the case of our generation, this assumption is likely to hold true. As a thought experiment, just compare the state of the world in 1500, 1600, 1700, 1800, 1900 and 2000: the worlds were very different; partially as a result of discontinuities such as war or inventions, partially as the result of cumulative processes. Then consider the rate of change we are currently experiencing in areas as diverse as an emerging global sustainability consciousness, population growth, biotech, robotics and nanotechnology, or imperial hegemony, to name just a few. The world in 2100 is likely to be very different from today, and this begs the question of likely transition paths.

The previous sections have inquired into global philanthropy's changing "logic of action". Around the world, charitable foundations and philanthropists perform many functions in exercising their mandate. The issues in question, the nature of philanthropic work, the strength of local civil society, and the scope and dynamism of the respective public and private sectors all co-determine a wide range of specific roles for philanthropy. All roles are important, and are typically not mutually exclusive. There is strong evidence that an inefficient social capital market has burdened the non-profit sector so far with high transaction costs and constrained its growth, producing fragmentation of initiatives. This is well documented in the case of the US, where less than 0.1% of non-profits founded in 1970 or after had reached an annual turnover of US$ 50 million or more by 2003.[60]

Now a structural change to these roles is under way. Given the general challenge of how to make globalization work for everyone in the twenty-first century, and how to keep the planet inhabitable for future generations, this paper argued that an invaluable window of opportunity has opened up for global philanthropy to create greater impact, and that new forms of designing, financing and running social change initiatives will drive progress.

Termed "the four revolutions in philanthropy under way", social entrepreneurship, microfinance, base-of-the pyramid investing and the entrepreneurial internalization of externalities are four cutting-edge theaters of the broader market revolution which global philanthropy is undergoing. It will lead to a more thoughtful and effective use of financial resources for social change. Grantmaking will not disappear, but market tools will provide a key ingredient to delivering philanthropic impact in scale. Moreover, many unconquered "old" frontiers persist: think of how to make partnerships work, measure impact, or be truly strategic rather than just claiming to be.

The recent financial crisis will end up accelerating this revolution. Philanthropy is at a reflexive moment. Prior to the crisis, there was some self-congratulation in the field, and a sense of a new Gilded Age – the equivalent of Nobel Laureate Albert Michelson's (1852-1931) famous statement that "all that remains to do in physics is fill in the sixth decimal place". We know the next chapter in the history of classical physics. Rather than confirming the classical paradigm, the search for the sixth decimal place led to the emergence of quantum theory, developed in a series of conferences funded by Belgian industrialist Ernest Solvay between 1911 and 1927 – another contribution of global philanthropy.

Calling into question some of the established wisdom about philanthropy, this paper has similarly argued that four secular trends are transforming the field of global philanthropy in fundamental ways. Today, social entrepreneurship, microfinance, base-of-the-pyramid investing, and innovations in grantmaking are far from representing the hegemonic mechanism of how philanthropic capital is allocated. But they are already helping to reorient practice in the mainstream of philanthropy, and eventually will become center stage.

Ultimately however, the four revolutions in global philanthropy are pieces in a larger puzzle. Globalization, long-term demographic trends, changing consumer preferences, and the state of public finances are jointly driving a deeper change. Philanthropy is becoming more effective and market-oriented, but businesses are also becoming more sustainability and meaning-oriented, jointly establishing an “Impact Economy” for the first time in human history.

Analogous to the “New Economy”, the “Impact Economy” will fundamentally transform business, civil society and the public sector, creating a multi-trillion dollar integrated social capital market, companies who seek authentic engagement instead of PR-focused corporate social responsibility, and private risk capital funding the design and delivery of public goods on a significant scale.

8. Suggestions for Further Reading

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9. Endnotes

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3. For a discussion of the general context, see for example Arthur Wood and Maximilian Martin, "*Market-based Solutions for Financing Philanthropy*", Viewpoints (UBS Philanthropy Services), 2006, 58-63, (http://papers.ssrn.com/sol3/papers.cfm?abstract_id=980097). See also Social Finance, "*Social Finance Welcomes the Government's Initiative to Pilot Social Impact Bonds as Announced in Their Policy Paper 'Putting the Frontline First: Smarter Government' Launched Today by the Prime Minister*", news release, December 7, 2009 (http://www.socialfinance.org.uk/downloads/press_releases/Press%20Release%20SIB%20Dec%2009%20FINAL.pdf). For philanthropy in the great recession, see Maximilian Martin, "*Managing Philanthropy in a Downturn*", Viewpoints (UBS Philanthropy Services), 2009, 110-126 (http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1322403).

4. See Lewin, "*Field Theory in Social Science"*, and Bourdieu, "*Outline of a Theory of Practice"*.

5. For a discussion of the emerging social entrepreneurship field, see for example Maximilian Martin, "*Surveying Social Entrepreneurship: Toward an Empirical Analysis of the Performance Revolution in the Social Sector*", Working Paper, Center for Public Leadership 2, University of St. Gallen, 2004 (http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1319499).

6. Bourdieu elaborates these positions as a function of *habitus* and capital (for a *discussion*, see Bourdieu, "*Outline of a Theory of Practice"*, 159-183). Bourdieu's concept of social fields is partially inspired by Kurt Lewin's vector psychology. It "refers to both the totality of actors and organizations involved in an arena of social or cultural production and the dynamic relationships among them". In social psychology, Kurt Lewin's field theory was highly influential (see for example Lewin, "*Field Theory and Experiment in Social Psychology"* for a collection of articles; see Lewin, "*Field Theory in Social Science"*).

7. Collective misrecognition and conflict are central to Bourdieu's notion of the dynamics that shape social fields. To grasp the characteristics of a social field, consider the concept of a field in a game (Bourdieu, "*The Logic of Practice"*, 67, emphasis in original): "In a game, the field (the pitch or board on which it is played, the rules, the outcome, at stake, etc.) is clearly seen for what it is, an arbitrary social construct, an artifact whose arbitrariness and artificiality are underlined by everything that defines its autonomy - explicit and specific rules, strictly delimited and extra-ordinary time and space. […] By contrast, in the social fields, which are the product of a long, slow process of autonomization, […] one does not embark on the game by a conscious act, one is born into the game, with the game; and the relation of investment, *illusio*, investment, is made more total and unconditional by the fact that it is unaware of what it is. As Claudel puts it, 'connaître, c'est naître avec', to know is to be born with, and the long dialectical process, often described as 'vocation', through which the various fields provide themselves with agents equipped with the *habitus* needed to make them work, is to the learning of a game very much as the acquisition of the mother tongue is to the learning of a foreign language".

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9. Meehan, Kilmer and O'Flanagan, "*Investing in Society*", 35.

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12. Data from SiRI Company (2007), quoted in Munich RE, "*Munich Re Shares as a Sustainable Investment*", 2008 (http://www.munichre.com/sustainability/en/economy/munich_re_share/default.aspx); Eurosif, "*European SRI Study (2006)*", p5, p13 (http://www.eurosif.org/publications/sri_studies_2006_2003); and most recent Eurosif "*European SRI Study (2010)*" (http://www.eurosif.org/research/eurosif-sri-study/2010)

13. See Ruth Sullivan, "*SRI Funds Popular in Europe*", Financial Times, October 17, 2010 (http://www.ft.com/cms/s/0/b0a4161e-d885-11df-8e05-00144feabdc0.html#axzz19mCill9n); see also Antoinette Hunziker-Ebneter and Oliver Karius, Forma Futura Invest AG, "*Sustainable Investment to Enhance the Sustainable Quality of Life*", presentation, oikos Anniversary Conference, St. Gallen, Switzerland, October 2007 (http://www.oikos-international.org/fileadmin/oikos-international/Resources/071017_OIKOS_Presentation_Forma_Futura_long.pdf). The UK accounted for 20% of the total EUR 53bn of European SRI assets, making it the second biggest market after France which had a 27% share. The number of SRI funds in the UK increased from 86 to 98 over 2009. See Lorraine Cushnie, "*SRI Funds Hit by Market Turmoil*", Investment Week, November 13, 2009 (http://www.investmentweek.co.uk/investment-week/news/1562065/sri-funds-hit-market-turmoil).

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15. See Monitor Institute, "*Investing for Social and Environmental Impact (2009)*", 9 (http://www.monitorinstitute.com/impactinvesting/documents/InvestingforSocialandEnvImpact_FullReport_004.pdf).

16. See Wood and Martin, "*Market-based Solutions for Financing Philanthropy"* (http://papers.ssrn.com/abstract=980097).

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22. There are numerous examples of such company plus foundation structures.

23. See TOMS (http://www.toms.com/).

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