FSG
FOUNDATION STRATEGY GROUP
Perspectives on Corporate Social Investment
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SEED Funds:
A Powerful New Approach to Corporate Social Investment

by Greg Hills

As multinational companies strive to become truly "global," they have begun to see the scourge of poverty, hunger and disease in developing countries as inescapable problems that they can and must help to solve. The traditional tools of corporate philanthropy, however, often seem unequal to this task.

Corporations already contribute generously to build schools, hospitals and roads or to donate medicines and equipment in developing countries, but most donations offer only short-term relief, fostering an ongoing dependence on the corporation's support without creating long-term sustainable solutions. Typical corporate grantmaking rarely takes advantage of the company's unique assets, expertise and infrastructure, severely limiting the social and business value created. Even the desired reputational benefits for the business can be as unsustainable as a headline or photo op in yesterday's newspaper. In short, traditional corporate philanthropy is akin to pumping air into a leaky tire – once you stop pumping, the tire will quickly deflate.

Innovative Tools for Social Change

New approaches have emerged, however, offering far more leveraged and sustainable solutions. One of the most powerful new ideas is the Corporate Small Enterprise Economic Development (SEED) Investment Fund – a term coined by FSG to describe the use of corporate funds and expertise to stimulate investment in for-profit enterprises that address social problems and foster economic development.

This innovative, market-driven approach to philanthropy can be used to develop private, sustainable enterprises in a wide range of sectors in the developing world, including health care, food, energy, technology, and housing. By absorbing the early risk and contributing their expertise, global companies can open up new sources of capital for small and medium size enterprises that meet social needs. As these businesses grow, they simultaneously help to address social problems and improve the local standard of living by creating new job opportunities. Equally important, they continue as sustainable enterprises, enabling global companies to provide lasting solutions in place of temporary aid.

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Shell's Uganda Fund

To understand the power of this approach, consider the Shell Foundation's Small Enterprise Investment Partnership in Uganda. Shell has a substantial presence in Uganda where there is also a sizable poor and rural population without access to energy. Small regional energy companies were capable of serving the rural population, but lacked the capital to expand. Foreign aid was insufficient, and local banks were unwilling to take the risk of lending to these small enterprises. Rather than increasing its donations, Shell decided to try a SEED Investment Fund.

Shell approached local banks in Uganda, proposing a $5 million loan fund targeted toward helping local small and medium size energy-related enterprises expand. Shell's charitable foundation put up $2.5 million, insulating the company itself from taking financial risk on this unproven concept. Local banks committed the remaining $2.5 million, based on the credibility and clout of Shell. In addition to capital, Shell provided business advice based on its deep knowledge about the energy business, and a willingness to work with local companies, using them as suppliers and providing them with energy to distribute and resell.

Initially, Shell anticipated weak financial results – a significant default rate or, at best, a 5% return. Instead, early results suggest a 95% repayment rate and as much as a 20% IRR. Small companies were able to demonstrate their creditworthiness, creating new jobs and bringing energy to households that previously lacked access. Local banks learned that small businesses could be reliable borrowers and modified their lending practices, stimulating further economic expansion. Based on the success of their first SEED Investment Fund, Shell is now assembling a $40 million second round and anticipates that its operating units in five other countries will establish similar Funds using corporate capital. Having proven the concept, the Foundation no longer needs to absorb the risk as a charitable endeavor, with the result that a $2.5 million foundation investment has generated over $40 million in social investment from other sources.

Shell has gotten a tremendous reputational lift from its innovative approach and the results it has achieved. Its local competitive context has been strengthened and, having demonstrated the economic viability of these loans, the Foundation has unlocked access to new sources of capital that leverage many times over the amount of its initial investment. Finally, the solution is self-sustaining – the access to rural energy created is neither dependent on foreign aid nor further charitable support.

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Applying the Concept More Broadly

The idea of combining investment capital with corporate expertise to solve social problems through for-profit ventures can be applied to a wide range of circumstances in developing countries. SEED Investment Funds channel philanthropic capital toward businesses traditionally underserved by private investment due to risky economic conditions and low anticipated investment returns. As a philanthropic endeavor, achieving an economic profit is not essential and the corporation can take risks that neither it nor other investors would normally accept.

Demonstrating the viability of private businesses in these target sectors and geographies has the snowballing effect of attracting new entrepreneurs and additional investors. By successfully supporting and developing businesses outside traditional private capital flows, SEED Investment Funds increase the visibility and awareness of these opportunities for private investors. As bankers and private equity investors learn the business and technical aspects of new industries, as well as the potential for economic returns, the likelihood of additional capital flowing to these sectors is significantly increased. And, as more private capital freely flows toward businesses that provide inherent social benefits, a platform for significant social change has been established.

Rather than using charitable dollars to compensate for market failures where for-profit investment could never work, SEED Investment Funds tend to highlight "market gaps" where for-profit investment could be successful, but the risks and rewards have not been tested before. In many ways, microfinance is one example of a variation on a SEED Investment Fund. Nonprofit pioneers demonstrated the social benefit and economic viability of extremely small loans to indigent populations and by achieving attractive rates of return, they opened a new market to large-scale institutional investment.

Creating Value and Sustainability
SEED Investment Funds offer companies the opportunity to deploy value-creating assets such as credibility, skills, networks and infrastructure that all serve to create value beyond check writing. Corporations can offer not only capital, but also the necessary technical assistance to increase the viability and success of their investment targets. This requires that there be an explicit connection between the target sector and the core business of the corporation. Shell, for example, chose to invest in energy enterprises instead of choosing to invest in ecotourism, construction or health care businesses – such a close connection offers more credibility and an opportunity to truly add value. Further, investments in companies that could be potential suppliers or customers can bring the added benefit of increasing a corporation's long-term competitiveness in the region.

Unlike traditional grants, the results of a successful SEED Investment Fund are sustainable. Developing viable local businesses that have the ability to pay back their loans means that the companies will likely be able to survive without future grant funding. Second, working closely with local banks creates a growing infrastructure of sector-specific investment knowledge, expertise and interest in committing local capital to new economic sectors.

In addition to social value creation and sustainability, SEED Investment Funds also appeal to the growing insistence on achieving measurable results in philanthropy. Specifically, they satisfy the increased desire to identify and meet measurable social impact goals from charitable activities.

Finally, a key difference between traditional philanthropy and a SEED Investment Fund is the "recyclable" nature of its funding. Unlike grantmaking activities which, by definition, are never repaid to the donor, the financing received from a SEED Investment Fund must be repaid according to the terms of the investment. Such a financial liability requires the private business to take strategic and operational steps to create a viable, going concern in order to meet its financial commitments. This arrangement applies an inherent discipline over the private business that is not present within a traditional donor-grantee relationship, and it permits the donor to re-use the same funds on multiple occasions.

The concept of a SEED Investment Fund as a philanthropic vehicle for global corporations is very new. However, the greatly increased pressure on corporations to meet social needs, and the willingness to reassess the social value of their current philanthropic efforts, suggests that the time is right for global corporations to exert a leadership position in corporate philanthropy by designing innovative and effective approaches to solving the world's toughest problems. SEED Investment Funds are one powerful example of the new tools available to leading corporations.

If FSG can help your company in developing innovative solutions that deliver both social and business impact, please give us a call.

FSG News

Clients

FSG's work covers a wide range of social investment issues for corporations and foundations around the world:

Corporations

FSG is working with a major European multi-national to define the company's CSR strategy and to quantify the business value of the full range of the company's interactions with society.

FSG is beginning work with a leading U.S. technology company to develop the company's strategic plan for philanthropy. This includes the development of new philanthropic signature initiatives.

Private Foundations

FSG is working with the Bill and Melinda Gates Foundation to research the capabilities of global pharmaceutical companies in the commercialization and donation of drugs in developing countries and emerging markets. The Bill and Melinda Gates Foundation supports drug research and development, and successful distribution, to reduce the incidence of specific diseases in the developing world.

Community Foundations

FSG is working with the COF Community Foundation Leadership Team to explore new possibilities for collecting and analyzing data about community foundation finances and operations, through the proposed development of a Community Foundation Center for Financial Insights.

We've Moved!

FSG has relocated its Boston office. Our new address is 20 Park Plaza, Suite 320
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Look for more information on FSG's upcoming SEED Investment Funds Webcast

For information on how FSG can help your company please contact:

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About FSG

The Foundation Strategy Group was founded to support organizations in accelerating the pace at which society's most pressing problems are solved. With offices in Boston, San Francisco and Geneva, our international team of consultants is drawn from the world's top strategy firms and dedicated exclusively to developing philanthropic and CSR strategies that achieve measurable results.

Our operational experience enables us to assess the impact of current giving programs or design worldwide management systems that link philanthropy, CSR, and social investment. Our investment in ideas, depth of practical experience, and collaborative approach, keep us at the forefront of the field and help our clients create greater impact.

For more information call us or visit our website.

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