

 Omidyar Network

ACROSS THE RETURNS CONTINUUM

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Table of Contents

Delivering Maximum Impact	1
Finding Our Way	3
Laying a Foundation	4
Defining Market-Level Impact	6
Pioneering a New Model	6
Providing Industry Infrastructure	7
Influencing Policy	9
Developing Our Framework	10
The Returns Continuum Framework	10
Category A – Commercial Investments	11
Category B – Subcommercial Investments	13
Category C – Grants	15
Reckoning with Complexity	16
Starting a Conversation	18
Endnotes	20

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DELIVERING MAXIMUM IMPACT

People in the impact investment community have long debated whether there is a necessary trade-off between social impact and financial return. Some argue that investors must sacrifice financial return in order to maximize social impact, claiming that profit-maximizing behavior inevitably leads a company to drift away from its social mission and to decrease its focus on beneficiaries. Others argue that the opposite is true—that there is a strong positive correlation between social impact and financial return. They assert that the best way to maximize impact is to create a profitable commercial firm that can grow rapidly by generating a healthy cash flow and by tapping into capital markets. A firm that lacks access to growth capital, after all, will be unable to scale up adequately.

This debate has raged for years, creating much more confusion than insight and hampering the development of the impact investing field. Is there a trade-off between financial return and social impact? Many impact investing leaders are eager to answer “Yes” or “No” in response to that question. Our experience at Omidyar Network over the past decade has led us to a different answer: “It depends.” In some cases—perhaps even most—a strong positive correlation does exist between financial return and social impact. In other cases, a company can generate significant social impact even if its financial return is modest.

Omidyar Network is a philanthropic investment firm that aims to catalyze social impact on a large scale. We work in multiple geographies, we fund both commercial businesses and nonprofit organizations, and we focus on investing in five sectors: education, emerging technology, governance and citizen engagement, financial inclusion, and property rights. The impact investing field, in our view, must move beyond the unproductive debate over trade-offs and instead focus on a more relevant question: Under what conditions should an investor accept a risk-adjusted below-market return in exchange for an opportunity to achieve social impact?



Education Emerging Technology Governance and Citizen Engagement Financial Inclusion Property Rights

Under what conditions should an investor accept a risk-adjusted below-market return in exchange for an opportunity to achieve social impact?

In this whitepaper, we present a framework for investing across the returns continuum—a continuum that extends from fully commercial investments at one end to philanthropic grants at the other. This framework reflects our belief that there is a broad range of viable investment profiles, some of which involve a trade-off between social return and financial impact, and many of which do not.

We argue that investors should consider accepting below-market returns only in certain limited circumstances. At Omidyar Network, we accept such returns only—with very rare exceptions—when we are intentionally pursuing market-level impact. And we have developed a clear framework for assessing that kind of impact. Adopting such an approach should not provide an excuse for investing in weak business models. But in certain circumstances, we believe, impact-oriented investors should adjust their return expectations in order to support companies that have the potential to catalyze new markets that will drive social change.



FINDING OUR WAY

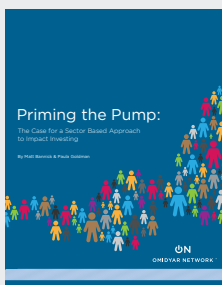
The value of investing across an expected returns continuum wasn't obvious to us at first. When we began our impact investing journey, we built a commercial venture capital portfolio to complement an existing grant portfolio, and in each case we maintained a high requirement for social impact. For the commercial portfolio, moreover, we considered only opportunities with strong prospects of generating risk-adjusted market-rate returns. Relaxing this standard, we believed, would lead us to invest in ineffective businesses and would potentially distort the very markets that we were trying to develop. We thought that the only way to achieve large-scale impact was to build large commercial enterprises that could generate enough cash to support both organizational growth and market-level impact.

Many phenomenal entrepreneurs needed more patience and more upfront capital than a commercial investor would typically provide.

But as we began investing more heavily and more directly in early-stage companies that targeted less advantaged populations in emerging markets, we began to notice the complexity of these market segments. Again and again, we saw phenomenal entrepreneurs who were developing innovations with transformative potential—but many of them needed more patience and more upfront capital than a commercial investor would typically provide. These entrepreneurs faced challenges that included limited access to startup equity, poor infrastructure, costly and ineffective supply chains, vague and unhelpful regulatory policy, limited consumer education, and a shortage of disposable income among consumers. They needed investors who would look beyond the financial bottom line. (See “Laying a Foundation” on the next page.)

LAYING A FOUNDATION

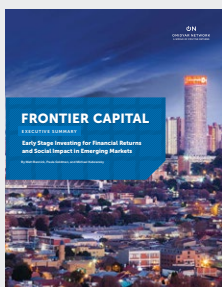
Over the past decade, Omidyar Network has created an ambitious impact investing portfolio. Alongside that effort, we have followed an ambitious agenda for studying—for defining and making sense of—the impact investing field. This whitepaper, in fact, builds on previous stages in the development of our thinking. We outlined our evolving perspective on the field at two of those stages in a pair of earlier reports.



In “Priming the Pump” (2012), we highlighted the need for impact investors to pursue change not just at a firm level but also at a sector or market level. In making that argument, we laid out three types of investments that are necessary to create healthy market ecosystems:

- 1. Market Scalars:** Firms that follow proven business models
- 2. Market Innovators:** Firms that create new models for new markets
- 3. Infrastructure:** Work that aims to solve problems faced by all firms in a given market

We have incorporated this analysis into our investment strategies across multiple sectors.



In “Frontier Capital” (2015), we extended this line of thinking by applying it specifically to businesses that serve low-income and lower-middle-income populations in emerging markets. These businesses, we argued, essentially fall into three categories:

- 1. Replicate and Adapt** covers proven business models of the kind that now draw the bulk of venture capital funding.
- 2. Frontier** covers unproven business models that may fit into a conventional venture capital portfolio because they are asset-light and serve a variety of income groups.
- 3. Frontier Plus** covers unproven business models that may not fit into a conventional venture capital portfolio because they are asset intensive or serve only lower-income groups.

In the report, we urged impact investors to direct more funding to all three categories, and in particular we called for more investment in Frontier Plus firms that have little hope of attracting mainstream commercial funding.

Now, in this whitepaper, we share insights from a third stage of our thinking. The concept of a returns continuum helps us to connect the theme of market building that we explored in “Priming the Pump” to the analysis of business models that we presented in “Frontier Capital.” Our work continues to evolve. But we believe that the returns continuum provides a comprehensive framework for impact investing—a framework for combining commercial capital, subcommercial capital, and grant capital to support promising investees and the markets in which they operate.

Our recognition of the value of investing across the returns continuum coincided with an increasing emphasis on driving market-level change.

We were not alone in developing this outlook. Mission-driven investors such as the Acumen Fund and the Shell Foundation had already invested “patient capital” in businesses that served low-income populations, and they deserve considerable credit for their innovation. We learned a great deal from their experience as we created our own approach.

Crucially, our recognition of the value of investing across the returns continuum coincided with an increasing emphasis on driving market-level change. We had come to see that even the most innovative firms come and go, whereas markets have the ability to create lasting social change.¹ Considering investments in low-return businesses required us to test our original logic: Is it really true that subcommercial investments invariably generate small-scale impact? And do such investments invariably have a distorting effect on nascent markets?



After considerable analysis and robust internal debate, we arrived at **four insights** that have clarified the conditions under which we will accept subcommercial returns.

The impact of a firm can extend well beyond its direct effect on customers. Indeed, even firms that achieve only modest financial success can have a considerable impact by accelerating the development of a market that reaches an underserved or disadvantaged population. This kind of market-level impact has become the main criterion against which we judge investments that have a subcommercial profile.

Subcommercial investments function in effect as subsidies and therefore have the potential to distort a market. For that reason, we exercise great care when providing grant or subcommercial capital, particularly in an emerging market segment that has multiple players.² We have found, however, that some markets are so nascent that there is no existing market structure to distort. In many cases, moreover, the need for subcommercial investment is temporary: Once a given business proves successful, it will yield market-rate returns that draw the attention of commercial investors. In other cases, a long-term subsidy may be necessary in order to fund market infrastructure or other shared goods that do not provide a commercial investment opportunity.

In evaluating a subcommercial investment, one critical point of reference should be a nonprofit or taxpayer-funded vehicle that aims to achieve the same objective as that investment. And unlike a subcommercial business, a solely grant-funded organization will tend to need continued grant support in order to scale up. In our view, it is better to fund a subcommercial enterprise that is pioneering a new market than to allocate money to a solution that requires this kind of perpetual subsidy.

Relaxing our return expectations should not lead us to relax the rigor with which we evaluate investments. For that reason, we need to make sure that our investment teams have a clear view of impact expectations when they assess specific opportunities. Developing this capability was by no means a straightforward task, and our investing practice continues to evolve in response to what we learn.



DEFINING MARKET-LEVEL IMPACT

Many impact investors regard the value that a firm delivers to customers as the primary, or even exclusive, measure of its social impact. Investing in that kind of impact is important, of course. But it's equally essential for investors to support organizations—particularly early-stage, high-risk firms—that have the potential to achieve market-level impact. Indeed, we have come to believe that by helping to build or shape a new market, a company can generate social impact that far exceeds its firm-level impact. In our experience, a firm can create market-level impact in three basic ways.

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1. Pioneering a New Model

Sometimes markets—particularly those that serve low-income or rural consumers—take a while to develop. And sometimes serving those consumers requires the creation of business models that differ from the models used to serve higher-income groups.³ By offering high-risk, patient capital, impact investors can enable a firm to prove the viability of a new model. If the model is successful, it will inspire other firms to follow suit, and the emergence of competition will in turn drive down prices, increase quality, and spark innovation. In this sense, the market impact of a pioneering firm encompasses all of the customers served by all of the firms that ultimately enter the market that it helps to create. In assessing a pioneering firm, therefore, impact investors should weigh not just that firm's expected financial return and its expected direct impact on customers, but also the benefits that could arise from launching an entire new model.

The microfinance market provides one of the best-known cases in which patient capital helped create an entire new market.⁴ But there are other examples of this process. Consider the market for consumer solar products in developing regions of the world. One Omidyar Network investee, d.light, provides solar lanterns and home solar systems to customers in Africa, China, and South Asia (as well as the United States). Part of its founding mission is to tap solar power in order to eliminate the use of noxious, expensive kerosene in low-income countries.

When we initially invested in d.light, the market for consumer solar products was completely unproven. But over several years, d.light demonstrated the commercial viability of its first offering—low-cost solar lanterns—by designing innovative product models and by building effective distribution channels in its target markets. In so doing, the company paved the way for other solar lantern providers.

A second d.light offering involves low-cost home solar systems. Initially, the company sold those systems mainly through a company called M-Kopa, which acted as its distribution partner in East Africa. But M-Kopa later terminated its exclusive relationship with d.light and eventually began selling home solar systems on its own. Other firms entered this market as well, and many of them developed novel product and service offerings. (Off-Grid Electric, for instance, uses a leasing model.) It's too early to tell which solar equipment providers will prevail. But it's clear that early support for d.light by Omidyar Network and other investors accelerated the development of a robust new market that now includes multiple firms.

d.light is a global leader in solar-powered solutions for people without access to reliable electricity. They are the largest distributed solar lighting brand for households and small businesses in off-grid communities. Their innovative, affordable solar-energy solutions are transforming the way 65 million people all over the world use and pay for energy.



127 GWh
generated from
renewable
energy sources



34 billion
productive hours
created for working
and studying



2. Providing Industry Infrastructure

Some markets, in order to develop effectively, require critical pieces of enabling infrastructure. The creation of this infrastructure, however, sometimes lags because no single market player wishes to assume the cost and the risk of investing in it. That is all the more true when such an investment is likely to benefit potential competitors.

The need for exotic currency hedging in microfinance offers a case in point. Microfinance originally evolved as a nonprofit endeavor. As companies sought to commercialize the field, they found that the lack of affordable currency-hedging capacity inhibited the development of an efficient market. In particular, they encountered the problem of currency mismatch: Many microfinance institutions (MFIs) draw funding from investors based in the United States or in Europe, and that funding is in hard currency. Yet MFIs, to meet the needs of their borrowers, lend out money in local currencies that have very low liquidity. As the microfinance market grew, the MFIs' currency risk grew as well. But few financial institutions offered hedging products for the relevant local currencies, and institutions that did offer those products often imposed onerous collateral requirements on customers.

We made this investment because we believed that MFX could have a catalytic impact on an important and growing market.

To solve that problem, a group that included Omidyar Network, the microfinance investor Accion, and other market stakeholders established MFX, a for-profit limited liability company that offers currency-hedging and education services. Founded in 2009, MFX operates essentially like a co-op: Its owners—MFIs and foundations—are also, in many cases, its customers. By design, it seeks to earn only a modest return. Indeed, given the high transaction costs that come with handling less liquid currencies, its profit potential remains limited. Since its founding, MFX has been able not only to fill the currency-hedging gap but also to eliminate the collateral burden on MFIs. (MFX achieved the latter goal in part through a public-private partnership with the US Overseas Private Investment Corporation.) To date, the company has facilitated the hedging of more than \$1 billion in microfinance capital.

For Omidyar Network, investing in MFX was a natural complement to our direct support for MFIs. Even though the return profile of the firm was subcommercial, we made this investment because we believed that MFX could have a catalytic impact on an important and growing market.

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3. Influencing Policy

A firm can also shape overall market conditions by prompting governments to change or clarify their policies, or by sparking debates on issues that affect the policy environment for a particular business model.

Bridge International Academies, for example, works in several African countries and in India to provide school system interventions that improve learning outcomes for children. Bridge is testing two of our criteria for market impact: Not only is it pioneering a new model for a new market, but also it works with policymakers to facilitate an enabling regulatory environment for that model. The Bridge model centers on offering a technology-supported curriculum, and the organization delivers this curriculum both in its own privately run schools and in public schools that it manages under government contract.

In 2009, when Omidyar Network invested in Bridge, only a few co-investors were willing to join us in supporting the company. Many investors perceived it to be a risky undertaking, both operationally and from a regulatory perspective. We accepted the returns profile for this investment because we saw the potential for exceptional impact: Bridge, if it succeeded in delivering positive educational outcomes for students, would demonstrate the value of its model, and it would catalyze policy change to enable models of this type to flourish.



**450+ academies in four countries
with more than 400,000 students**

Bridge has made solid progress on both of these dimensions. In Kenya, the company directly operates private schools and serves more than 100,000 relatively low-income students. Overall, those students have shown strong gains in educational attainment. In addition, Bridge has contributed to a policy debate in Kenya about the role of so-called complementary schools—schools of the kind that Bridge operates. In Liberia, Bridge has contracted with government to manage public schools, and it is now applying its curriculum in those schools. It has also worked to bring about policy changes that make such arrangements possible.

In both Kenya and Liberia, then, Bridge has sparked important debates about the role that private sector companies like Bridge play in education. Such policy debates can be contentious. But in our view, they are a healthy and necessary part of market development.



DEVELOPING OUR FRAMEWORK

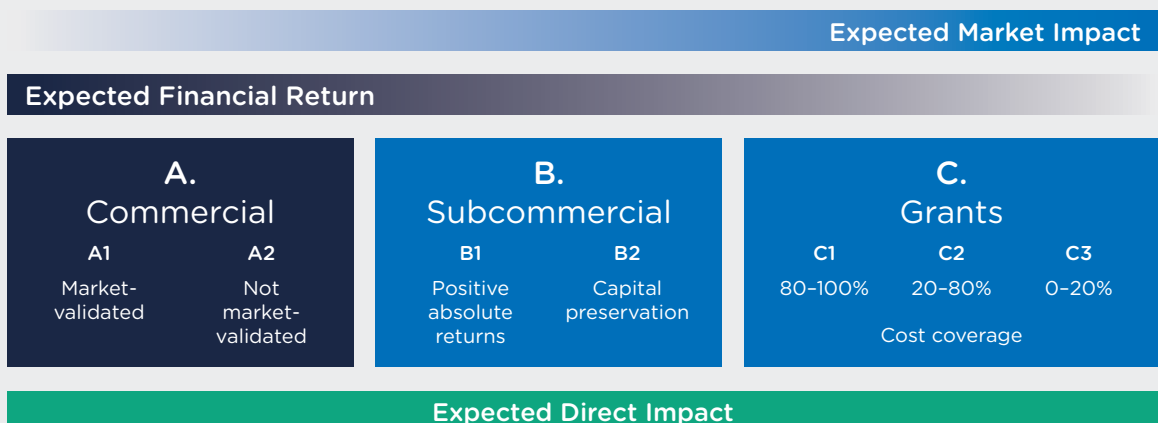
Identifying these three dimensions of market impact—new models for new markets, market infrastructure, and policy impact—was an important step for Omidyar Network. It allowed us to define the conditions under which we would accept subcommercial returns. Using that analysis as a foundation, we created a “returns continuum” framework that allows us to consider subcommercial investments and grants alongside commercial investments.

When we evaluate an investment, we begin by confirming that it can have a direct (or firm-level) impact. Then we assign the investment to one of the categories on the returns continuum. We base the choice of category on a combination of expected financial returns and expected market impact. Investments that we expect to generate a risk-adjusted financial return belong in Category A; we do not require evidence of their potential market impact. Category B and Category C include investments for which we expect subcommercial returns. With these investments, we require a compelling case for an investee’s potential to create market impact.

Category A and Category B encompass for-profit investments. With these investments, our expectation of market impact increases as our returns expectation decreases. As we move along the returns continuum from Categories A1 and A2 to Category B1 and then to Category B2, we expect to see an increasing level of market impact. In other words, the greater the financial “concession,” the more compelling the expected market impact needs to be. For investments in Category C, which includes grants to nonprofit organizations, we expect a high level of impact but do not expect any financial return.

The Returns Continuum Framework

For all of its investments, Omidyar Network has the same high expectation for direct (firm-level) impact. But expected market impact and expected financial return vary by type of investment.





Category A – Commercial Investments

We expect all investments in this category to achieve positive social impact and strong financial returns.

We expect all investments in this category to achieve positive social impact and strong financial returns. At the same time, we avoid investing in companies whose financial prospects make them vulnerable to mission drift. In some cases, a desire to maximize financial returns may lead a company to raise prices or to target more affluent consumers, thereby undermining its social mission. To reduce that risk, we target companies that have social impact “embedded in their business model”—regardless of whether they explicitly pursue such impact. These companies follow a model that ensures that they will deliver direct social impact simply by serving their customer base.

Within Category A, we differentiate between A1 investments, in which we have commercial co-investors that provide market validation—because their presence signals a market expectation of commercial returns—and A2 investments, in which commercial co-investors are absent. This distinction highlights our ability to evaluate investment risks differently from how other investors evaluate the same risks. Thus, with an A2 investment, the risk profile that we assign to a company is lower than the risk profile that commercial investors would assign to it. We make such an assessment because, relative to commercial investors, we may have greater familiarity with a given geography (such as Africa) or sector (such as financial inclusion) or more confidence in a particular entrepreneur.

A1 investments in our portfolio tend to cluster in regions (such as the United States, Europe, and India) that have well-developed venture capital markets. Many of these companies—for example, Dailyhunt (formerly Versé Innovation)—take proven business models and transplant them from markets where they work well to markets where they require adaptation to a local context.⁵

Dailyhunt, based in India, is perhaps best known for offering a top-ranked app that provides news and book content in 11 Indian languages, as well as in English. Our direct impact thesis for the company was twofold: We believed that it would bring a wide range of content to India’s large, underserved non-English-speaking population. Today, Dailyhunt is the country’s most popular aggregator of local-language content. It distributes material from more than 600 news publications and about 1,600 e-book publishers, and its website registers 3 billion page views per month. And we believed that Dailyhunt would innovatively serve its market. It has done so, for example, by developing the Flipboard for Kindle for non-English languages.



Dailyhunt has significantly expanded the market for local-language publishing in India—a market that other internet companies, and traditional publishers as well, have neglected.

We had high expectations for commercial returns from this investment, and we invested alongside a commercial co-investor, Matrix Partners India. As a result, we could justify the investment without needing to consider its potential for market impact. Even so, we did have market impact expectations for Dailyhunt, and the company has largely met them: Dailyhunt has significantly expanded the market for local-language publishing in India—a market that other internet companies, and traditional publishers as well, have neglected. In addition, it has developed a capability known as direct carrier billing, which enables users to pay for the Dailyhunt service via their mobile operator rather than via credit or debit card. (Many people in the company’s customer base do not use such cards.)

With a Category A2 investment, we expect commercial returns, but there are no commercial co-investors joining us in the deal. That description applies to many investments that we make in markets outside of the United States. In many cases, the most promising new companies in these markets serve low-income and lower-middle-income consumers, and commercial investors typically do not view those consumers as profitable to serve. In addition, few venture capital firms operate in these markets.

One such company, PT Ruma, provides financial and information services in Indonesia. Ruma has built a network of trained sales agents by drawing from the ranks of small-business owners throughout the country. Through this network, the company delivers a range of services, including utility and loan payment processing, mobile money transactions, and insurance. Today, the company employs more than 800 people in more than 60 cities, and it operates a network that consists of more than 100,000 sales agents. To date, it has processed more than 50 million transactions.

When Ruma first set out to raise funding, however, its prospects were far from certain. Indonesia, to be sure, offered a vast potential market. But scaling up the Ruma model would depend on the company’s ability to recruit sales agents from a large and widely dispersed array of rural communities. In addition, Ruma was an early-stage business in a country where the venture capital market was also at a nascent stage. (According to data from the Emerging Markets Private Equity Association, only five venture capital transactions took place in Indonesia in 2011 and 2012.)

Omidyar Network recognized these risks. But in assessing Ruma, we also saw significant potential both for direct impact on a large scale and for strong financial performance. Since our initial investment, Ruma has grown considerably, and in subsequent rounds it has attracted support from commercial funders that include PT Sequis, an Indonesian insurer; Golden Gate Ventures, a regional venture investor; and Garena, a leader in the Southeast Asian tech market. For that reason, we now classify the company as a Category A1 investment.

As these examples show, Category A investments can deliver significant market impact, even if doing so was not an expectation at the time of investment. (Ruma, for instance, is demonstrating the viability of mobile money in Indonesia.) Category A companies, because of their ability to earn or attract capital, have a high capacity for growth, and the ability to scale up is often a critical factor in driving market impact. Other companies will be unlikely to enter a new market, and governments will be unlikely to adopt market-enabling policies, if a pioneering company has not first gained traction within that market.



Category B — Subcommercial Investments

For investments in this category, we accept the prospect of lower financial returns in exchange for the promise of significant market impact. Just because a company creates market impact does not mean that it will generate strong financial returns. Companies that pioneer new models in new markets frequently need time to overcome market-specific barriers and to establish the viability of their model. Similarly, companies that are building out market infrastructure or working to influence policy often fall short of generating commercial returns. We distinguish between two types of Category B investments: We expect B1 investments to deliver positive absolute returns, though not necessarily on a risk-adjusted basis. With B2 investments, our primary expectation for returns is that we will preserve our capital.

Category B1 includes investments in companies such as MicroEnsure, which provides insurance to low-income families in Africa and Asia. MicroEnsure originated in 2002 as a nonprofit project within Opportunity International. Knowing that the right kinds of insurance products can increase financial stability for low-income households, the team at Opportunity International sought a way to make those products attractive and accessible. In the past, most insurers that serve this customer segment either have gained little traction or have required a significant subsidy to remain in business. For many low-income families, the concept of insurance can seem abstract, and attending to other, more urgent needs takes priority over buying a product whose benefits lie in the future.⁶

MicroEnsure developed a model that aims to overcome such barriers. In this model, customers can submit claims via text messaging, and the insurer will pay out claims on the word of a local leader—an imam, for example. Often the insurer will pay out on claims almost immediately. In addition, product distribution is essentially automatic: To enhance customer loyalty, mobile carriers bundle the MicroEnsure offering with purchases of predefined amounts of airtime. This model, in short, caused the barriers of access and abstraction to dissolve, and adoption of MicroEnsure products took off quickly.

In 2012, after establishing strong consumer demand for its products, MicroEnsure spun out from Opportunity International and became a for-profit social enterprise. To support that transition, Omidyar Network made an initial investment in the form of convertible debt. Then we made an equity investment in the commercial firm that emerged from that process. In assessing this investment, we concluded that we could expect positive returns but not positive risk-adjusted returns. We were willing to accept this level of return because we believed that if MicroEnsure succeeded, it would not only serve millions of people directly but also help build a nascent market.

We accept the prospect of lower financial returns in exchange for the promise of significant market impact.

Today, MicroEnsure has more than 40 million registered customers in 20 countries. It has continued to scale up, thanks in part to investments by two large insurance providers: AXA and Sanlam. The growth of MicroEnsure, moreover, has inspired new entrants into the micro-insurance market, such as Bima and Inclusivity Solutions.

Category B2 investments, like those in Category B1, are ones that we expect to generate significant market impact. The distinguishing feature of these investments is that their financial returns are very difficult to predict. That is because companies in this category are often pioneering markets in which private sector involvement has been practically nonexistent. Although these investments have the potential to generate financial returns, our primary expectation for those returns is that they will enable us to preserve our capital. (B2 investments make up a small portion of our portfolio.)



Target communities were able to complete property formalization three times faster and 43 percent cheaper.

Suyo, for example, is a company based in Colombia that helps low-income families in urban areas formalize their ownership of property. Its service combines a property data platform with mobile technology to expedite the formalization process. The idea for Suyo emerged from a pilot project undertaken by Mercy Corps in 2012. Omidyar Network funded the project, and two men who later cofounded Suyo—Matt Alexander and Marcelo Viscarra—led the effort. The pilot, which took place in Bolivia, involved testing the service in seven communities while simultaneously testing the use of traditional formalization methods in 23 control communities. The target communities, as it turned out, were able to complete property formalization three times faster and 43 percent cheaper than the control communities.

Alexander and Viscarra set up Suyo as a for-profit company whose mission is to build a scalable and affordable property formalization service. The company's emphasis on affordability and its focus on property rights—a matter that typically comes under the purview of the public sector—together add a layer of uncertainty to efforts to project its financial performance. Yet we believed that this company has the potential both to influence policy regarding property rights and to pioneer a new market for property rights services. We also noted that because its model leverages mobile technology, Suyo would not require a large amount of capital to scale up its service. For these reasons, we were comfortable with making an investment with the expectation that our return would meet, but might not exceed, our capital preservation threshold.

Significantly, some commercial funders are now considering investments in Suyo. These potential funders range from microfinance organizations such as Fundación Mario Santo Domingo (which is part of the Kiva portfolio) to utility companies that have an interest in building a base of customers who have secure property rights. That development validates our belief in the market potential of Suyo's model.



Category C — Grants

At Omidyar Network, we do not expect to receive any capital back from any of the grants that we make, and we hold all grants to a high expectation of market-level impact. But within this category, we divide grants into subcategories that reflect the degree to which a grant recipient will cover its costs through its operations. (The purpose of this distinction is simply to describe the financial model of each grant recipient. This information comes into play in the long-term management and analysis of our portfolio.)

Grants in Category C1 go to organizations that we expect to become financially sustainable over time. (More specifically, we anticipate that these organizations will eventually be able to cover 80 percent to 100 percent of their costs through earned revenues.) Take DonorsChoose.org, an online marketplace where teachers and individual donors collaborate to bring students in US public schools the resources that they need to learn. DonorsChoose originally relied on grants from Omidyar Network and other supporters to cover its operational expenses, but in recent years it has shifted to a model in which it charges fees to donors who use the site. Category C2 grants, meanwhile, go to organizations that are likely to become partially sustainable over time. (Our specific expectation is that they will earn revenue that covers 20 percent to 80 percent of their costs.)

We do not expect to receive any capital back from any of the grants that we make, and we hold all grants to a high expectation of market-level impact.

Category C3 grants go to recipients that are likely to generate little to no revenue. (We expect these organizations to cover 20 percent or less of their costs.) The Open Government Partnership (OGP), for example, is an international initiative that works to secure commitments by governments to practice transparency, to empower citizens, and to reduce corruption. Since its inception in 2011, OGP has expanded to cover 70 member countries, and it has enabled more than 3,000 government commitments. OGP has limited potential for earning revenue, but Omidyar Network offers grant funding to the partnership because it provides a public good—better, less corrupt government—that has broad market impact.



RECKONING WITH COMPLEXITY

Developing an idealized investment framework is one thing; applying that framework consistently in the real world is another. Without question, the returns continuum framework has brought increased clarity and rigor to our investment and impact assessment processes. Yet it remains a work in process. In refining our use of the framework, we have encountered a variety of messy real-world complexities.



Predicting social impact is harder than predicting financial return.

Our investment professionals are able to identify and quantify an expected rate of return for each proposed investment. But expected impact—particularly expected market impact—is far more difficult to calculate. The pursuit of such impact, after all, depends on the actions of many external actors. Predicting outcomes for early-stage companies is especially challenging: Those firms tend to pivot many times before they settle on the business model that they will take to scale.



Comparing actual impact with expected impact is harder than comparing actual return with expected return.

Especially at a market level, it takes longer to create real social impact than to generate financial returns. Social impact, moreover, sometimes occurs in unexpected ways—particularly if a firm changes its approach or if the dynamics of a market shift. To address this challenge, we now require our investment professionals to articulate a testable investment hypothesis and an expected path to impact at a firm level (and, if relevant, at a market level) when they make an initial investment. That way, when we make subsequent investment decisions, we will have a set of detailed baseline expectations that we can compare with actual impact.



Actual returns differ—often markedly—from expected returns.

The focus of our framework is on predicted returns rather than actual returns. But as early-stage investors recognize, there is often a big difference between the initial expectations for an investment and its performance over time. In fact, some investments that we originally assigned to Category B have financially outperformed some Category A investments. Similarly, and not surprisingly, some Category A investments have delivered market impact that far exceeds the market impact delivered by some B investments. The returns continuum has become a vital tool for making our investment decisions, but we do not rely on that tool to predict or explain long-term portfolio performance.



Good financial benchmarks are hard to find.

Our framework requires us to determine a risk-adjusted commercial return expectation for each investment—yet our method for doing so remains fairly ad hoc. In most of the regions where we invest, data on early-stage investment performance for impact-relevant sectors is scarce. Benchmarking our investments is therefore quite challenging. That's one reason why we rely on market validation by co-investors, and why we also support research on early-stage investing in emerging markets.



The danger of lazy investing is real.

The core premise of our framework is that only high expectations of market impact justify accepting higher risk or reduced return expectations. But there is always a danger that investors will use an imprecise “market impact” rationale to justify support for a poorly run business or an unsuccessful business model. The risk here is that such an investment might be not only ineffective but also market-distorting. We also worry that some people will conclude that “impact investing” means investing less efficiently or less effectively. For these reasons, we take care to avoid accepting subcommercial returns just because we have a framework that allows for them.



Maintaining consistency is difficult—but also essential.

Our portfolio covers a broad range of sectors and geographies, and managing it is an inherently subjective exercise. So setting expectations and assigning investment categories across the portfolio is a persistent challenge. Assessing the expected market impact of a financial services firm, for instance, is much different from assessing the expected market impact of an independent media company. Our investment professionals work to achieve as much consistency as possible.



STARTING A CONVERSATION

Asking whether impact investing does or does not require an impact-for-return trade-off presents investors with a false choice. Focusing on that question not only keeps willing capital on the sidelines; it also prevents investors from developing realistic frameworks by which to measure success on both the impact front and the financial front. To move past that false choice, impact investors must recognize that returns exist along a continuum—and that both direct impact and market-level impact should figure in their evaluation of potential investments.

In our work, we have discovered many opportunities that will generate both direct impact for consumers and market-rate returns for investors. Indeed, much of our portfolio fits this description. But we have also learned to be comfortable with investing in firms that offer below-market returns in exchange for an opportunity to produce outsized market impact.

Of course, not all investors have the flexibility or the desire to invest across the returns continuum. According to the Global Impact Investing Network, nearly 60 percent of self-identified impact investors expect to achieve market-rate (or higher) returns. Some of these entities, such as pension funds, have little choice but to seek the highest possible returns for their stakeholders.

Other investors, however, are able and willing to take outsized risks in pursuit of social impact. In some cases, they are willing to assume those risks without an expectation of risk-adjusted returns. For these investors, the concept of a returns continuum should be an essential tool. By pursuing investments that have a wide range of return and impact profiles, flexible impact investors can help to reduce or eliminate the risks associated with new markets. In that way, they can also create opportunities for strictly commercial investors to scale up promising innovations.

Several important groups have begun to embrace a continuum approach to impact investing. We urge these investor groups to move further in that direction.



Ultra-High-Net-Worth Individuals (UHNWIs)

Members of this group—people with investable assets of more than \$30 million—control \$30 trillion, or 12 percent of global wealth.⁷ In the United States, the 400 richest people have a combined net worth of nearly \$2.5 trillion and an average net worth of \$6 billion.⁸ UHNWIs have an immense opportunity to put that capital to work in socially beneficial ways.

Today, both established philanthropic families (such as the Pritzkers and the Rockefellers) and philanthropists who have emerged more recently (such as Bill and Melinda Gates and Priscilla Chan and Mark Zuckerberg) are showing leadership as impact investors. We encourage other UHNWIs to reject the false dichotomy that separates philanthropy from investing—and to consider opportunities to achieve social impact across the returns continuum.



Development Finance Institutions (DFIs) and Bilateral Donor Agencies

These institutions have an explicit mandate to support market building. Too often, however, they face incentives that drive them to pursue only market-rate investing. By taking into account market-level impact as well as firm-level impact, DFIs and donor agencies can hone their ability to fulfill their mission. We recognize that a number of DFIs are taking a lead on this issue, and we also applaud the recent establishment of funds—the Global Innovation Fund and the Catalyst Fund, for example—that incorporate a flexible approach to impact investing.



Foundations

The proportion of money that philanthropic institutions allocate to impact investing remains remarkably small. In 2013, less than 2 percent of the \$55 billion deployed by foundations went into investments rather than grants, and an even smaller portion of that sum—less than one half of 1 percent—went into equity-based investments.⁹ But a shift is underway within philanthropy. Institutions such as the Ford, Gates, Heron, MacArthur, and McKnight foundations are using the full array of tools at their disposal—from program-related investments that come out of their grantmaking funds to commercial investments that draw from their endowments. We hope that other foundations will follow suit.

The returns continuum framework that we present here emerged from the experience of building and managing the Omidyar Network portfolio. We are still refining that framework and learning how to apply it. We are also eager to learn about alternative perspectives. Conversation and debate—*informed by real-world experience*—will further enable impact investors to gain the insight that they need to tailor their investment decisions to their impact and return preferences.

Endnotes

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9. Data courtesy of Mission Investors Exchange.



OMIDYAR NETWORK

A WORLD OF POSITIVE RETURNS

Omidyar Network is a philanthropic investment firm, established in 2004 by eBay founder Pierre Omidyar and his wife Pam. We create opportunity for people to improve their lives by investing in market-based efforts that catalyze economic and social change. In India, Omidyar Network focuses on helping the hundreds of millions of Indians in low-income and lower-middle-income populations, which we define as ranging from the poorest among us to the existing middle class. Omidyar Network has committed more than \$1 billion through equity investments in for-profit companies and grants to nonprofit organizations that foster economic advancement and encourage individual participation across multiple areas, including Digital Identity, Education, Emerging Tech, Financial Inclusion, Governance & Citizen Engagement, and Property Rights.

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