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The Nature of Returns: A Social Capital Markets Inquiry into Elements of Investment and The Blended Value Proposition

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Foreword

The author would like to thank and acknowledge the contributions of the following individuals who agreed to review and provide feedback on this paper:

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In addition, it should be recognized that there are few ideas in this world which are generated independently and fully formed. Many of the concepts presented in this paper came about as the result of conversations held between the author and his colleagues at Harvard Business School. In particular, I would like to thank *Jim Austin, George Baker, Diana Barrett, Hank Chesbrough, Allen Grossman, Grant McCracken, Lynn Paine, Julia Rubin, and Ed Smith.* I am also indebted to *Peter Frumkin, Christine Letts* and *Mark Moore* of the John F. Kennedy School of Government. Discussions with each of these individuals provided the context within which our thoughts, coming together, created the sparks for seeing new connections and ideas—many of which are contained herein.

A word about Words: This paper lives in a space where social and financial concepts, terms and language intersect. With the exception of contractual payments, it is the opinion of the author that all social sector financial resources are capital infusions and investments—whether charitable contribution, below market loan or annual gift. Readers more comfortable with the notion that a grant is a grant and an investment is an investment are forewarned. Furthermore, in this conceptual world, social value is viewed as having the potential to generate financial and other returns to a variety of stakeholders. Because this fluidity of language blending social and financial constructs may confuse some, where possible, the paper defines terms. However, the author does assume a level of familiarity on the part of the reader with the fact that we live in a time of evolving concepts regarding capital, investment and return—concepts which may mean more than their initial or historic use might infer. Future papers may include extended glossaries, tracking the various applications of different words and concepts, however for the time being it will simply be assumed the reader understands that a central part of the current challenge is divining the deeper meaning of "common" words and is open to such exploration.

A word about Audience: This paper is published as part of Harvard Business School's Working Paper Series. The intended audience includes academic and practitioner, as well as for-profit *and* philanthropic investor. Efforts have been made to make this text both academically sound and accessible to the lay person. Some readers may find certain sections self-explanatory or introductory and others may find sections particularly dense. The paper was intentionally written that way in order to bring the largest cross-section of audience into this discussion. Naturally, the reader is free to skip sections not viewed as valuable or of serious import.

Navigating the Lay of the Land:
Social, Financial and Nonprofit Capital Markets

Whether the triumph of truth or success of a conspiratorial advertising campaign, it would seem that all things today are viewed as subject to "markets" and market analysis. Religious institutions analyze their members in efforts to better understand and meet the needs of their target market. And social service agencies first re-defined patients as clients and now as customers in a continuing attempt to successfully evolve in meeting the needs of those they seek to serve. While some may view as yet one more example of a deteriorating civilization the seeming dominance of business frameworks over every aspect of modern life, markets themselves are actually quite benign—they are simply physical or virtual spaces where actors come together in exchange of various items of value. These may be physical items—such as grain or pork bellies. Or conceptual items—such as the projected future value of grain or pork bellies. And, yes, markets even exist to guide and direct the exchange of social items—that is to say, social capital markets exist to facilitate the exchange and development of society's members and the institutions of which we are all a part.

The term "Social Capital" is used by academics and practitioners to describe various elements that interact to steer and create societal or community value. Before addressing the specifics of social capital investment and returns as they will be discussed in this paper, it should be recognized that there are many types of capital. At a minimum, there is financial capital, physical capital, human capital, social capital, natural capital and manufactured capital.[i] It is important to understand that current social capital discussions take place within this larger capital context. Our attention will focus upon the nature and interaction of two forms of capital: financial and social.

First, we will explore the target of these investments. What type of enterprise requires investment? What stages do they move through and how do the types of investor differ, if at all, depending on the developmental stage of the investee?

Second, we will review how financial capital in its various forms supports the creation of social value in the Nonprofit Capital Market. Who are the players in this type of capital market and what are the relative challenges they must overcome in order to effectively place their capital in motion?

With this introductory understanding of the recipients of investments (both for-profit and nonprofit), we will then examine the elements of "return." What returns do investors seek? How is social value traditionally understood relative to financial returns?

Next, we will present the types of institutions active in the marketplace in pursuit of various forms of return. How do mainstream capital institutions compare with community development finance organizations? How does a corporate foundation relate to its mainstream capital equivalent?

With this understanding of the way financial capital moves in relation to the creation of both financial and social returns, we will turn our attention to the specific question of social capital. What is it? How is it defined? And what is its relation to financial capital investment decisions?

Finally, we will move to a discussion of the reality that, in truth, one cannot pursue financial value without reference to social value creation. Conversely, the argument will be advanced that to attempt the pursuit of social value in the absence of an understanding of its intrinsic link to financial capital returns is folly as well. What is needed is an understanding of both the Blended Value Proposition and a Blended ROI (Return on Investment). The closing sections of the paper explore this understanding of the interaction between social and financial capital investments and returns within this context of a BVP and Blended ROI.

The paper then concludes with a discussion of the implications of a Blended framework for both investees and investors. What are the steps that will have to be taken if we are to truly operate in a world of blended investment and return? What challenges are raised by an analysis that rejects the traditional understanding of a trade-off between the pursuit of social value and financial return? These and other areas of inquiry must be explored in order to appreciate the full potential of a Blended Value Proposition.

The central issues are actually quite simple:

What do we value?

How do we track efforts to increase that value?

And

What is the most effective way to structure capital markets to maximize value?

Before responding to these questions, however, the existing nature of investment and return must first be addressed.

The Fundamentals of Investment:[2]

Whether social or commercial, the majority of investments involve providing resources to corporations and organizations that fall along a continuum. And all organizations require different types of investment depending upon their particular stage of development. As an illustration of this reality, the *Enterprise Development Framework* is now presented to portray the general type, stage and nature of corporations receiving investments within the Social Capital Market.

We begin with the understanding that while a corporation's legal status may be clearly defined as either for-profit or non-profit, in truth there is a spectrum of organizational culture and activities falling between the two extremes of social enterprise and commercial enterprise.[3] At one extreme, the goal of the investment is to maximize social value, while at the other, the intent is to maximize economic value.[4] In between these two poles, corporations and those investing in them seek to achieve some appropriate blend of social and economic value creation—whether clearly defined as such or as an incidental by-product of their activities.

As will be discussed later in this paper, corporations operating in this middle ground of commercial and social enterprise are increasingly being viewed as *hybrid organizations* (regardless of their legal status), with differing aspects of both social and commercial value creation. However, while corporations are legally considered either for-profit or non-profit, as will be argued later in this paper, all corporations have within them both social and financial/economic value—regardless of their legal status.

The corporations themselves fall along stages of development that begin with Seed and Start-up, moves through Secondary Stage and to eventual sustainability in the market. The stage of sustainability is one wherein various investors may enter and exit depending upon a range of investor considerations. In for-profit capital markets, at this stage investments are relatively liquid with returns being fairly well defined.

The time frame by which corporations move through these various stages was historically predictable, but is becoming increasingly less so. A decade ago, it was standard for corporations (both nonprofit and for-profit) to be built over a period of multiple years or decades. A corporation could, if its board chose, create great value for its investors as a

[2] Some have raised questions relative to whether "investment" in the nonprofit sector should include fee-for-service reimbursement or program contracts received by nonprofits from public funding entities. For the purpose of this paper, such monetary exchanges are viewed in the same way as "sales" are viewed in the for-profit sector. <u>Investments</u> speak to those funds provided to a corporation/organization in exchange for the creation of greater value in the market—not simply the provision of a given product or service.
[3] For a complete discussion of this continuum and its various aspects, please see "*The Social Enterprise Spectrum: Philanthropy to Commerce,"* J. Gregory Dees 1996, Harvard University. The expanded version of the Enterprise Continuum presented here builds upon, but adds to, the work of Dees and the author of the present paper acknowledges Dees's significant contribution in this area.
[4] The reader should note that in the chart the box "Maximizing Social Value" speaks to the intent of the nonprofit corporation receiving the investment—not the mainstream foundation that might be funding its work.

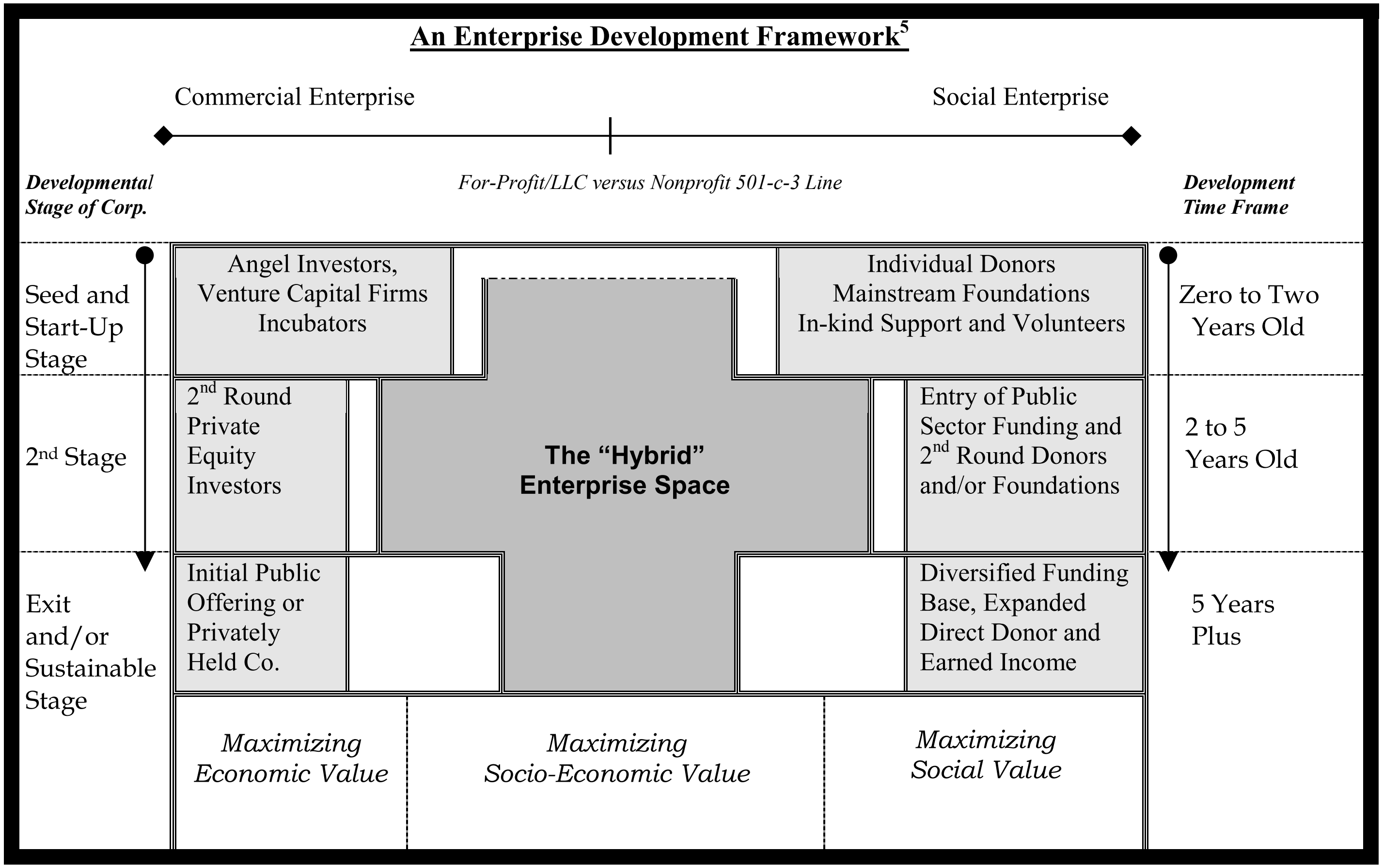
privately held company or, as a nonprofit, could pursue a "pet cause" of its founder/donors for years without the need or interest in attracting additional philanthropic investments. While in some ways this remains true, in recent years traditional and Internet based corporations are being held accountable for showing both market results and financial return in "net time." And, with both positive and negative effect, nonprofit organizations are also increasingly viewed through this lens of efficiency and accountability.

There is no doubt something to be said for the idea of ever increasing efficiencies and efforts to drive nonprofit organizations to achieve "scale" as some equivalent measure of impact and the effective usage of resources. However, the current push to maximize perceived value in increasingly minimized time frames must be questioned. It must be questioned not only in terms of its appropriateness to the social sector, but also in terms of its relevance to the true nature of time and the core essence of the value creation process in all organizations—both for-profit and nonprofit.

The consideration of social and financial value creation may require a re-definition of what is considered to be an appropriate investment period and under what terms specific types of returns will be calculated. This question is addressed at greater length in the final section of this paper. Regardless, what have historically been thought of as "appropriate" stages of development in both sectors are increasingly changing and the Enterprise Development Framework attempts to reflect that.

For this reason, the Framework simply presents the general developmental time frames of zero to two years; two to five years; and five years plus. The corporations moving along this time line will develop through various stages, attracting diverse investors seeking a range of returns on their investment. Under the current definitions of investment and return, upon entering this market, it is important for investors to understand what type of return they seek and to what extent they will pursue a financial return or a social return.

Much has been written regarding the structure and functioning of for-profit, financial capital markets. Business school libraries are full of volumes of information addressing that topic. However, much less is understood with regard to the structure and functioning of nonprofit capital markets. We now turn our attention to this discussion.



[5] This diagram builds upon the work of J. Gregory Dees (John Gardner Professor, Graduate School of Business, Stanford University) presented in *"The Social Enterprise Spectrum: Philanthropy to Commerce,"* 1996, Harvard University. This particular Enterprise Development Continuum was created by the author of the present paper to assist iStart Ventures in Seattle in creation of their philanthropic strategy.

Defining the Nonprofit Capital Market

As stated, the For-Profit Capital Market has been the focus of decades of work and reflection on the part of both business people and academics. The general stages of business and capital formation (seed, early, mezzanine, etc.) are broadly understood and agreed upon. Furthermore, the role played by various types of capital has also been clearly enunciated as taking various forms of debt and equity. And the performance of those making use of that capital is commonly analyzed through the application of a host of operating and financial ratios used by those managing or invested in a given enterprise, as well as third party market analysts.

By sharp contrast, definitions of the Nonprofit Capital Market are still in formation. Increasingly, this market is viewed as having significant relevance and potential impact upon its for-profit counterpart. Mainstream financial institutions increasingly view the social sector as a target market for their products and services and for good reason—it is a market harnessing significant resources and one that is in many ways quite profitable.

The social sector in the United States has 654,000 501-c(3), 140,000 c(4) organizations, and 341,000 religious organizations for a total of 1.14 million nonprofit[6] corporations. With revenues of $621.4 billion, the sector represents 6.2% of the national economy of the United States. And with over 10.2 million employees, the Social Sector makes use of 6.9% of the workforce.[7] Indeed, when one takes into account the role of non-governmental organizations operating throughout the globe, social sector actors are increasingly viewed as having significant impact on the mainstream economic and financial marketplace of not simply the United States, but nations around the world.

Nonprofit financial activities have a direct impact upon the for-profit arena and "business-to-business" transactions are viewed as significant to both the for-profit and social sectors. Commercial financial market activities include receiving lines of credit, paying employees salaries that are then spent in the mainstream economy and the maintenance of purchasing contracts with for-profit vendors. These activities are undertaken on a direct, business to business basis. The Social Sector, on a "straight" financial basis has a significant and increasingly profound impact upon the mainstream economic market place.

In addition to its economic and numeric value, the Social Sector also plays a major role in the maintenance of a "civil society." Without churches, schools and volunteer organizations, the richness and diversity of modern life would be greatly reduced. As we shall see later on in this paper, it is this very aspect of our community life, its "social capital," that we must reconsider and integrate more effectively into our understanding of value and worth in the context of the modern commercial society.

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[6] 501(c)3 corporations may be referred to as both non-profit and not-for-profit corporations.
[7] http://www.indepsec.org/homepage_documents/nonprofit_size_and_scope.htm

Beyond these activities, however, are those aspects of the capital market driven primarily *not* by the social or commercial interests and activities of actors in these commercial markets, but simply by virtue of the legal status of nonprofit corporations as 501-c(3) and c(4) entities. Such entities may receive grants, raise direct financial donations from individuals and access "below-market" forms of capital investment from outside institutions, in the form of Program Related Investments and other structured capital financing. Such entities, however, may not distribute the returns of their value creation activities to outside shareholders. In this sense, they are "non profitable," charged first and foremost with the maintenance and pursuit of *social* value in society. It is for that reason the players and instruments which connect the activities of those in this sub-market constitute their own universe and sphere of influence that may be referred to as the *Nonprofit Capital Market*. (Emerson, 1996)

The role of the public sector (i.e. governmental departments and related sources of funding) in this capital market is complex and changing. Prior to the early 1980s, the dominant funding strategy of many foundations was to support a pilot program or initiative and, if it was deemed a success, seek governmental funding to "go to scale" or "sustain" the program. Government funded "demonstration programs" and private foundations supported "innovative programs," with both assuming that long-term funding would come primarily from public sources. With the Reagan Revolution, the philosophy began to shift (although interestingly enough, the actual practice remained unchanged for a number of years) and increasingly nonprofit organizations were expected to diversify their funding sources. Today, in a period of record surpluses, programs are still receiving public sector support—especially with the current emphasis upon privatization and downsizing government. However, many nonprofit organizations remain locked in funding relationships based upon a demonstration project, contracting or service providing mode that does not involve the type of funding necessary to build either organizational capacity or long-term social value.

Over the years, public sector, private nonprofit, private foundation and, increasingly, business actors in the Nonprofit Capital Market have evolved their own set of operating relationships and rules of engagement. As depicted in the accompanying chart, players in this market consist of Nonprofit Actors on one side of the table and Funding Agents on the other. These entities are then "connected" in the market by funding instruments arranged along a financial continuum from grants, to recoverable grants to equity equivalents to commercial lending instruments. This Nonprofit Capital Market, while linked in many ways to the mainstream, for-profit capital market, actually operates with its own set of players and in accordance with its own rules.

In some ways the market "works" quite well. Millions of Americans benefit in a host of ways from the existence and activities of the nonprofit sector—a sector that annually sees the accumulation and transfer of billions of charitable dollars and countless volunteer hours. However, in other ways this market is highly inefficient and does not maximize the potential social value players active within it seek to create. At a minimum, this market could be said to reflect a number of characteristics:

- *Absence of Market Standards*
- *Lack of Proven "Return on Investment"*
- *Market Fragmentation*
- *Grant Making in Isolation*
- *Insufficient Resources and Capital Market Imbalance*
- *Various Investors, Various Instruments*
- *Development of An Emerging Knowledge Base*
- *Need for Additional Nonprofit Capital Market Research*
- *A Tension Between Learning Versus Funding*
- *The Need to Teach Funders to Learn*
- *The Tension between Market Cost Capital and Community-Based Need*
- *Market "Insiders" versus Market "Outsiders"*
- *Market Hype Versus Vision Grounded in Practice*
- *Atrophied Investor Relations*
- *Underdeveloped Concepts Regarding the Meaning of "Going to Scale"*

Each of these is discussed at greater length in other papers (Emerson, 1998). Suffice it to say the form of transactions in the Nonprofit Capital Market continues to come under increasing scrutiny as various analysts attempt to understand not simply the dynamics of the market, but how its efficiencies may be improved in order to maximize the creation of social value. For example, in building upon the inefficiencies of the Nonprofit Capital Market cited above, Allen Grossman (Grossman, 1999) adds the following characteristics to what he labels the Philanthropic Capital Market:

- *Criteria for capital allocation is idiosyncratic, opaque, ambiguous and based upon personal relationships and reputation*
- *There are few identifiable sources of capital dedicated to each organizational stage*
- *Donors operate independent of each other*
- *Donor motivation varies greatly within the Market*
- *Metrics to assist in identifying effective organizations are largely lacking*
- *Information systems to track effectiveness are lacking*

In addition to these factors, it should also be recognized that many of those charged with overseeing the operation of nonprofit organizations lack adequate management expertise (since we are "here for the cause" and many resist becoming "too business-like"). As a consequence, many lack a sophisticated understanding of those financial models that might lead toward greater degrees of organizational sustainability. The ultimate impact of these factors is the creation of a capital market where investment decisions are often driven by function of "politics, perception and persuasion" (Emerson, 1998) which come together to lock nonprofit leaders and those who fund them within what one observer has gone so far as to label "a dance of deceit." Whether or not one shares this degree of abject cynicism, many are concerned that the existing structure of the Nonprofit Capital Market may not be maximizing the resources and efforts of individuals and organizations active within it.

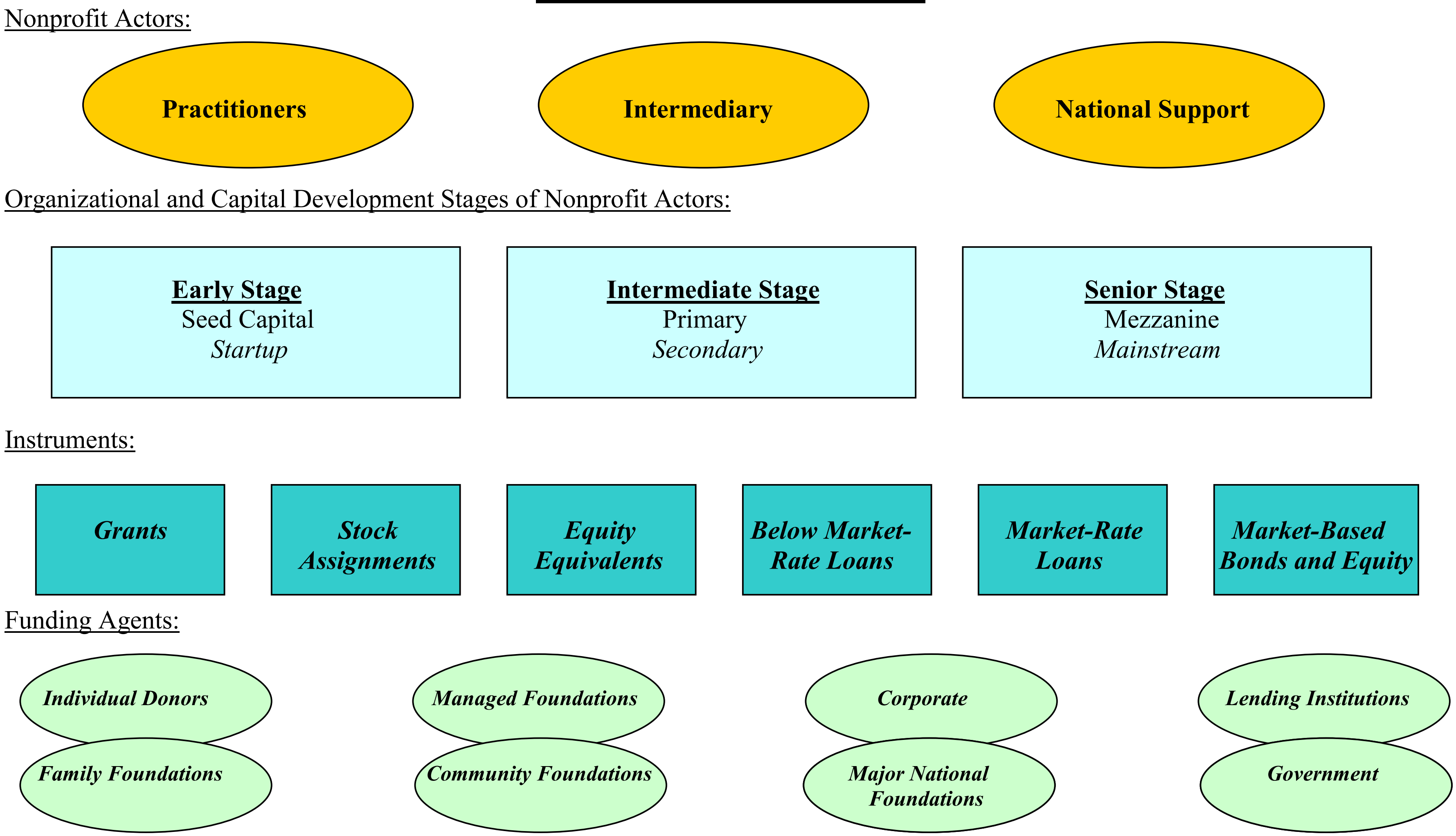
In large measure, these market inefficiencies are linked to the fact that much of the Nonprofit Capital Market is engaged in what may be called *Transactive Philanthropy*.[8] Within Transactive Philanthropy the focus of attention comes to rest upon the transaction itself. For funders, success is defined in terms of the size and number of grants awarded. For grantees, it is a function of how many grants one can secure and how large an operating budget one can amass. Thus the emphasis is placed upon the act of the transaction with value being defined in terms of that transaction itself and not in terms of what long-term value is generated as a result of the transaction. In order for sustainable social value to be created in the Social Sector, capital market actors must move from Transactive Philanthropy to *Investment Philanthropy*.

Within Investment Philanthropy, one measures success not as a function of asset size, but social return; one understands movement toward a social mission not relative to the number of grants secured, but according to the true social value generated as a result of one's efforts, the application of resources in support of those efforts and actual added value generated as a consequence of these activities. Transactive Philanthropy does create some value and, no, the Sector is not a complete loss—however the notion that sustainable, *maximized* social value is being created through the efforts of both parties is questionable.

Understanding the basic structure and functioning of the Nonprofit Capital Market is important, but leads naturally to a discussion of what value is sought by investors in this market and how they understand their returns. The primary focus of this paper is an exploration of the social and financial returns generated by investments in the social capital market and it is to such a discussion we now turn.

[8] The phrase "Transactive Philanthropy" should not be confused with the term "Transactive Social Capital" presented later in this paper. The first refers to an approach to grantmaking, while the latter refers to a form of social capital present within the market.

The Nonprofit Capital Market[9]



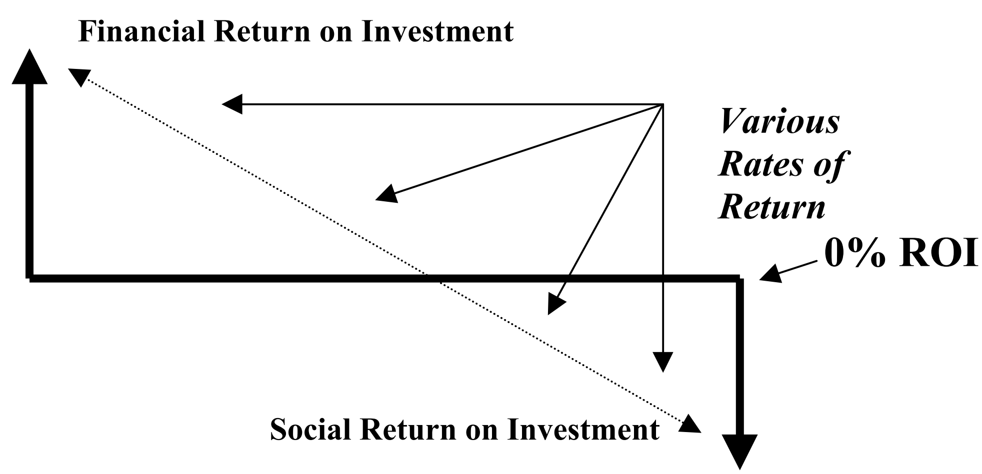
[9] *"The U.S. Nonprofit Capital Market: An Introductory Overview of Developmental Stages, Investors and Funding Instruments,"* authored by Jed Emerson and published by The Roberts Enterprise Development Fund, September 1998. Also included in the REDF Box Set released April 2000.

Elements of Return: Understanding the Investment Plane

Other documents have addressed the types of investment instruments available and the challenge of achieving an appropriate capital structure in the nonprofit capital market (Williams, 1998; Emerson, 1996). From the perspective of the for-profit financial investor, however, it is obvious that returns available from such investments are defined in financial terms and range from 0% to standard financial market rate and beyond. However, it must also be acknowledged that, in point of fact, individuals making financial contributions to nonprofit entities and seeking no direct financial return will still benefit financially by virtue of tax write-offs and other advantages they receive.

Just as the Enterprise Development Framework includes various types of corporations, both for-profit and nonprofit, creating a range of both social and economic value in the market place, the investor community consists of an array of investors, each pursuing his or her own investment goals and level of risk/return. The "full financial market" returns sought by a traditional venture capitalist do not allow for any amount of social return consideration. While, at the other extreme, a strictly philanthropic contribution seeks no amount of financial return, but attempts to maximize its social return on investment to the highest degree possible.[10] In between these two points is the *"Investment Plane"* supporting a range of returns. It is important to note that beneath the 0% level of the financial return line all returns are non-monetary. The challenge of measuring returns in this part of the investment plane is discussed later in this paper.

The Investment Plane:
A Traditional Perception of FROI[11] versus SROI



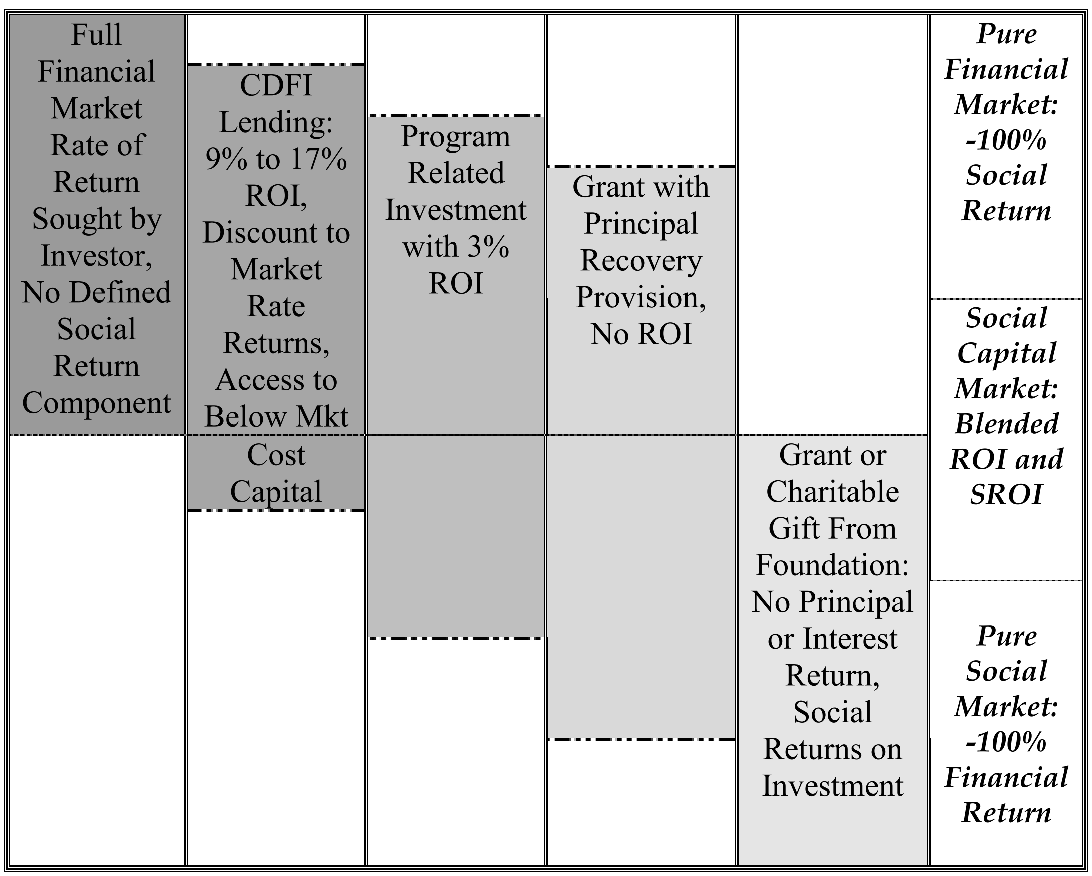
[10] A variation of the following discussion and graphs was released by the author in September 1999 as part of a Working Paper on Social Return on Investment. Individuals receiving advance copy were known to be researching FROI/SROI and are listed in the Appendix.

[11] Throughout this paper, FROI is defined as *Financial* Return on Investment (dollar or other monetized value), while SROI is *Social* Return on Investment, which speaks to a measure of social value creation resulting from the investment of financial or social capital.

Investment Instruments:

While the presence of some social element in all investments must be at least tacitly acknowledged, for-profit financial markets do not provide monetary investment return for social impact or value creation. And therefore social investors making use of traditional investment instruments must deal with the reality of the *Sinking Economic Return,* which comes to be experienced as a "profit penalty" and is the central deficit of the mainstream structure and understanding of investment and return. Namely, while there are commonly endorsed metrics for assessment of financial value creation as a part of ROI, there are none for assessment of social value creation. An investor in social capital development is expected to be financially penalized for the effort to create social value, while those creating financial value in society are expected to operate without reference to the social dimensions of their investment.[12] With the incurred "profit penalty," each instrument carries a "sinking *economic* return" the closer it achieves pure *social* returns.

The Sinking Economic Return:
Traditional Perspectives of
Financial Capital Markets Versus Philanthropic Gifts



[12] This fact is in part due to the reality that the traditional financial models assume public goods to be of "free use" to all and are therefore not represented as a cost or expense to the for-profit investment under consideration. If all true social and environmental costs were carried by those creating the expense, the nature of return on financial investment would be radically altered.

Investment Institutions:

Over time the Social Capital Market[13] has attracted a wide array of participants, each active in the market in pursuit of their own interests and returns defined in accordance with their particular investment goals. The following chart, *A Spectrum of Investor Institutions*[14], presents an overview of these investors. The general investor groups include:

- Traditional Philanthropy
- Venture Philanthropy
- Community Debt Financing
- Community Development Equity
- Social Venture Capital
- Socially Responsible Investment Funds
- Traditional Capital Institutions

In considering the characteristics of each player, the following points should be made:

First, investors range across a continuum from Social Equity investors to Private Equity investors. Their capital instruments, structure, legal status and pursued rates of return all flow from the degree to which they seek to play a role as either type of investor. In the nonprofit sector, this concept of equity is not, however, simply the same thing as "grants." Grant funds do not connotate any element of the source of those funds being formally vested in or "owning" a stake of a given investee. Grant funds are quite simply that—a grant of funds—and do not in and of themselves carry any measure of equity ownership (social or otherwise). The concept and implications of Social Equity versus Private Equity as related to the ability to secure capital are further explored below, but it remains that different investors pursue and maintain various levels/forms of equity within those organizations receiving their investments.

Second, Traditional Philanthropy will often have endowments invested in Traditional Capital Institutions in order to pursue a full *financial* market rate of return—but most often without reference to whether or not those funds are also being leveraged in the pursuit of *social* returns. While, on the other hand, Traditional Capital Institutions will often pursue full financial returns without regard for the social return potential of their investments, but then often establish corporate, family foundation or other vehicles through which they seek to "give back" to the community. This has been referred to as the "schizophrenia of capitalism,"[15] and in many ways works to undermine the overall effort to create greater social value in the market as a whole.

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[13] A definition of Social Capital Market is discussed at length in later sections of this paper. In *this* context, we refer simply to those making financial investments in socially oriented ventures.

[14] Again, this chart was distributed in September of 1999 to the SROI Working Group described in the Appendix to this paper.

[15] William Rosenzweig (Entrepreneur and Venture Capitalist) in conversations with the author.

As recently reported in the New York Times, "…(F)oundations, especially larger ones, have not been in the forefront of the social investing movement. When it last surveyed its membership in 1997, the Council on Foundations found that slightly less than 15 percent screened for any social or ethical consideration. Small foundations, those with assets of less than $10 million, were almost twice as likely to do so as large ones, those with assets of $100 million or more, according to the survey."[16] And, of course, the individual private equity investor version of this is represented by those who practice socially responsible investing side by side with their "market rate" investing—somehow viewing the two as separate investment goals as opposed to the one informing the other or understanding that both may be a part of a larger whole.[17]

Third, as one moves from Private Equity investing to Social Equity investing one confronts the reality that there is, at present, no provision for "ownership" of a nonprofit organization. Whereas from a political or organizational governance perspective this may make some sense, from a capital structure perspective one is severely limited in the ability to secure and raise funds. This is due in part to the fact that in the absence of appropriate FROI/SROI metrics, investors cannot lay claim to or "own" the social value they help generate by virtue of the investments they make.

Wherever there is vagueness in ownership, there are limited and inefficient capital markets with which to drive investment. In part, the lack of formal investment in Native American governmental territories rests with confusion regarding jurisdictional matters (i.e. what law will determine who owns what?); or in Third World countries with land that has contested titles of ownership, outsiders are hesitant to invest capital in developing, cultivating or protecting that property. In the social sector, this lack of clear ownership and assignment of equity values hinders an organization's ability to raise additional capital beyond that which it may beg or borrow.[18]

Within this understanding of "appropriate" fund raising for nonprofit organizations, entities are condemned to the role of charity-seeking supplicant. They often cannot quantify their worth and lay claim to rhetorical value: "We are community-based", "Our greatest resource is our volunteers." Such statements are nice and may assist in generating one's annual contribution of $25, but if the interest is in creating a capital structure capable of driving sustainable social change, one is hard pressed to finance an organizational strategy—regardless of its merit or effectiveness. One's capital development strategy relies upon "charisma" (a k a—salesmanship and marketing), spin and the pursuit of funding fads. Some break through this capital barrier, but most do not. The notion of calculating social equity or assigning a share value as a proxy of worth in the social sector is "cute" only if one is content with the present system of grants and donations. To move from charity to investing in change requires those who "own" that

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[16] New York Times, *Charities' Investing: Left Hand, Meet Right,* By Reed Abelson, 6/11/2000.
[17] While there are no doubt others who have made this point, significant advocates of linking philanthropic investments with social goals have been Woody Tasch and Stephen Viederman, both affiliated with the Jessie Noyes Foundation.
[18] These issues were raised with the author by Shari Berenbach of the Calvert Foundation.

future of transformation have the ability to track its performance over time—and tie that transformation back to the capital support and community resources that made it possible.

In the absence of the ability to issue "true" equity holdings in their future pursuit of social change and justice, those responsible for building the financial structure of the social sector must creatively make use of "equity equivalents" (Emerson, 1998). Equity equivalents (often defined as various types of debt instruments issued on terms that make them appear to function as "equity" in the overall capital structure of the nonprofit[19]) help create an adequate capital structure to underwrite an organization's development. In the process one may move from beggar to banker, making an increasingly demonstrable connection between the amount of capital invested and the social returns generated. A.G. Edwards & Sons recently introduced a Socially Responsible Equity-Linked Note that holds promise for bridging this equity gap,[20] and in the future the market will witness the development of other social sector credit enhancements and blended investment instruments. However, until the full development and broad application of such instruments, players in the social sector will continue to be significantly hobbled in their efforts to secure adequate capital structure financing.

It is also interesting to note that nonprofit corporations are not the only one's in need of new equity. Many community development venture capital funds target the expansion of business within the inner city or in rural areas overlooked by mainstream investors. The managers of these funds (referred to as community venture capitalists) are providing entrepreneurs with much needed equity to build their business—equity the mainstream market will not provide for a variety of social and economic reasons. It is for this reason such funds are referred to in the spectrum as "community development equity."

Finally, it should be noted that the Spectrum Institutions presented below are not divided into categories outlining where those investments may be targeted. Among a wide variety of areas, investors focus upon anything from housing to sustainable development or micro-enterprise. In many cases, the particular area of interest an investor targets may effect both the terms and structure of the capital they put into play in the capital market.

To this point, our discussion has focused upon the "investor side" of the issue—nonprofit investors, socially responsible investors, traditional investors and the various types of returns each hopes to achieve as a result of their capital infusions. Regardless of whether one is investing in a nonprofit or a for-profit, thus far we have discussed the monetary and financial aspect of investing and returns. We must now shift our focus to what has historically been viewed as the "other" side of the balance sheet—the social capital side. What is social capital? How does it interact with financial capital? And, most importantly, how are we to understand the leveraged value of the two? We turn now to a discussion of these and related issues...

[19] Debt is used since there is often a limit to the amount of "free cash" an organization can raise through contributions. The use of various types of debt instruments allows nonprofit organizations to offer their supporters different ways to assist the organization while having some assurance of receiving their principle at a future point in time. The use of debt simply expands the capital structure options available to the nonprofit manager in the same way it does the for-profit manager.

[20] In early 2001, the author will release an analysis of the A.G. Edwards' offering and its structure.

A Spectrum of Investor Institutions and Factors Related to their Activities[21]

Traditional Philanthropy	***Venture Philanthropy***	***Community Debt Financing***	***Community Development Equity/VC***	***Angel Investors and Social Venture Capital***	***Socially Responsible Investment Funds***	***Traditional Capital Institutions (Banks, Mutual Funds, Etc.)***
--Seeks to Maximize Social Return --Majority of applied funds not viewed as type of investment --May engage in Program Related Investments --"Evaluation" used to assess relative social impact --Often invests endowment in Traditional Capital Institutions	***--Seed Capital for innovative social or economic programs --No Market FROI --Documented SROI --Application of Venture Capital practice within Philanthropic context --<u>All</u> Charitable funds are viewed as a form of investment***	***--Positive Financial Return (fixed rate) --Positive assumed social impact, either through economic development or related social prgm support --Modest returns on investment compared to market rates --Includes CDFIs***	***--High Risk --Limited or No Financial Liquidity Event --Financial Returns Minimized --Investors or Financing Institutions may never get major money out, and are therefore challenged to accurately define/assess risk/reward***	***--Seed funding of business start-ups --Seeks Market rate financial returns -"Qualitative" or anecdotal social impact assessment --"Do no harm" screen or perhaps facilitate some type of social good --Pursue "Profits with Principles"***	***--Seeks Market rate financial returns --Seeks to minimize negative social, environmental or other impacts --Pro-active social, environmental or other screen for investing --May Engage in Social Audits and "follow-along" monitoring --Shareholder Activism --No calculation of SROI***	***--Seeks to Maximize Financial Return --May engage in CRA lending, but not part of core mission --Analysts simply "observe" performance and make no direct effort to influence the operation of the investee corporation --May engage in traditional philanthropy by making grants to nonprofit organizations --No thought of SROI***

Social Equity Investors ⟵⟶ ***Private Equity Investors***

[21] This continuum of returns is based in part on the 1998 work of Shari Berenbach (Calvert Foundation), as further developed by Timothy Freundlich (Calvert Foundation) and this paper's author. This chart was originally released by Jed Emerson as part of a Working Paper in September, 1999.

Defining the "Social" in Social Capital Market

The previous discussion addresses how financial capital is invested in corporations ranging from nonprofit to for-profit. And some of these investments seek to create a type of social value. But what, exactly, is the capital that generates *social returns*? To answer this question, one must first ask: What is the nature of social capital? The term "social capital" has become a relatively common one among academics, donors, socially responsible investors and community practitioners. Given that business academics, social scientists and those on the street all appear to apply different definitions to the same two words, we will first explore where the phrase originated and its current use.

As Robert Putnam has observed, the first use of the term "Social Capital" appears to have been presented by James Coleman in his paper, *"Social Capital in the Creation of Human Capital."*[22] (Coleman, 1988), in which Coleman states that:

> "Social capital is defined by its function. It is not a single entity but a variety of different entities, with two elements in common: they all consist of some aspect of social structures, and they facilitate certain actions of actors-—whether persons or corporate actors—within the structure. Like other forms of capital, social capital is productive, making possible the achievement of certain ends that in its absence would not be possible. Like physical capital and human capital, social capital is not completely fungible, but may be specific to certain activities. A given form of social capital that is valuable in facilitating certain actions may be useless or even harmful for others."[23]

Coleman's ideas regarding social capital were largely well received in the academic community, primarily among his initial audience of sociologists and social scientists, but it would be up to another intellectual capitalist to take this idea to market and achieve some degree of scale in terms of its popular currency.

In 1995, Robert Putnam released his widely read article, *"Bowling Alone: America's Declining Social Capital,"* and set off wide ranging debates regarding "what's wrong" with American culture and community. Putnam's quantitative analysis of the decrease in social capital, measured in terms of civic engagement and activity, was the first really to capture the public imagination. While "civic engagement"—of various forms—has become a commonly embraced understanding of the term "social capital," other authors have also addressed a variety of additional aspects of social capital. (Coleman 1988: Trust, Fukuyama 1995: Market Functioning, Warren 1995: Community Organizing, Verba et al. 1995: Volunteerism, Kanter 1997: Business). Indeed, just twelve years after

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[22] James S. Coleman, "Social Capital in the Creation of Human Capital," American Journal of Sociology, Volume 94, Issue Supplement: Organization and Institutions: Sociological and Economic Approaches to the Analysis of Social Structure, 1988, S95-S120. The statement that Coleman was the first to coin the phrase "social capital" is made by Robert Putnam in his 1995 article.

[23] Coleman, pg. S-98.

the initial introduction of the term, it is now commonly used and scores of abstracts and papers address its various aspects and forms.[24]

Space does not allow this paper to present a comprehensive review of the many contributors to the concept and definition of social capital in the social sciences. However, it is worth noting that, following a nod to Coleman for framing the basic concepts, Putnam, defines social capital as follows: "(b)y analogy with notions of physical capital and human capital—tools and training that enhance individual productivity—"social capital" refers to features of social organization such as networks, norms, and social trust that facilitate coordination and cooperation for mutual benefit." (Putnam, 1995).

Building upon this definition, still others have stated that social capital is defined as pertaining only to "those stocks of social trust, norms and networks that people can draw upon to solve common problems. Networks of civic engagement, such as neighborhood associations, sports clubs, and cooperatives, are essential forms of social capital and the denser these networks, the more likely that members of a community will cooperate for mutual benefit."[25]

However this last definition of social capital is in some ways a limiting one in that it is "horizontal," focusing upon a set of players within a given community. Social capital can also be thought of as having "vertical" dimensions. A vertical understanding of social capital is grounded in the perspective that while "horizontal ties are needed to give communities a sense of identity and common purpose…without 'bridging' ties that transcend various social divides (e.g. Religion, ethnicity, socio-economic status), horizontal ties can become a basis for the pursuit of narrow interests, and can actively preclude access to information and material resources that would otherwise be of great assistance to the community (e.g. …access to credit)."[26] And related concepts may be found in discussions comparing the "bonding" versus "binding" functions of social capital (Moore, 1999). As will be discussed, this "bridging" function becomes central to understanding the use of Transactive Social Capital, as presented below.

Building on both Putnam's writings and its own understanding of the vertical/horizontal nature of social capital, the World Bank defines social capital as "the institutions, relationships, and norms that shape the quality and quantity of a society's social interactions…social capital is not just the sum of the institutions which underpin a society—it is the glue that holds them together."[27] They further define the concept by describing seven sources and forms of social capital (each of which blend this understanding of vertical/horizontal or bonding/binding): [28]

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[24] World Bank Social Capital Market Data Base: www.worldbank.org/poverty/scapital/library/index.htm
[25] Civic Practices Network, Social Capital page: www.cpn.org/sections/tools/models/social_capital.html
[26] Http://www.worldbank.org/poverty/scapital/whatsc.html
[27] World Bank Web Page, http://www.worldbank.org/poverty/scapital/whatsc.htm.
[28] As pointed out by Jim Emerson, in truth, it must be said that these are not all truly comparable aspects of social capital. For example, the use of the word "communities" requires further explanation in that several of the other social capital sources (ethnicity, gender, etc.) could be thought of as "community." Civil

Families
Communities
Firms
Civil Society
Public Sector
Ethnicity
Gender

As implied in this definition, these concepts of families, firms and so on focus on what are best understood as the ***interactive*** nature of social capital. *Interactive Social Capital* is the web of relationships and social institutions that connect us to each other and community. Interactive Social Capital may be understood as that social capital which is generated by virtue of the human and community interactions within and between the component parts of society. However, while this "glue" is critical to the maintenance of society and central to the health of any community, it is but one side of the coin.

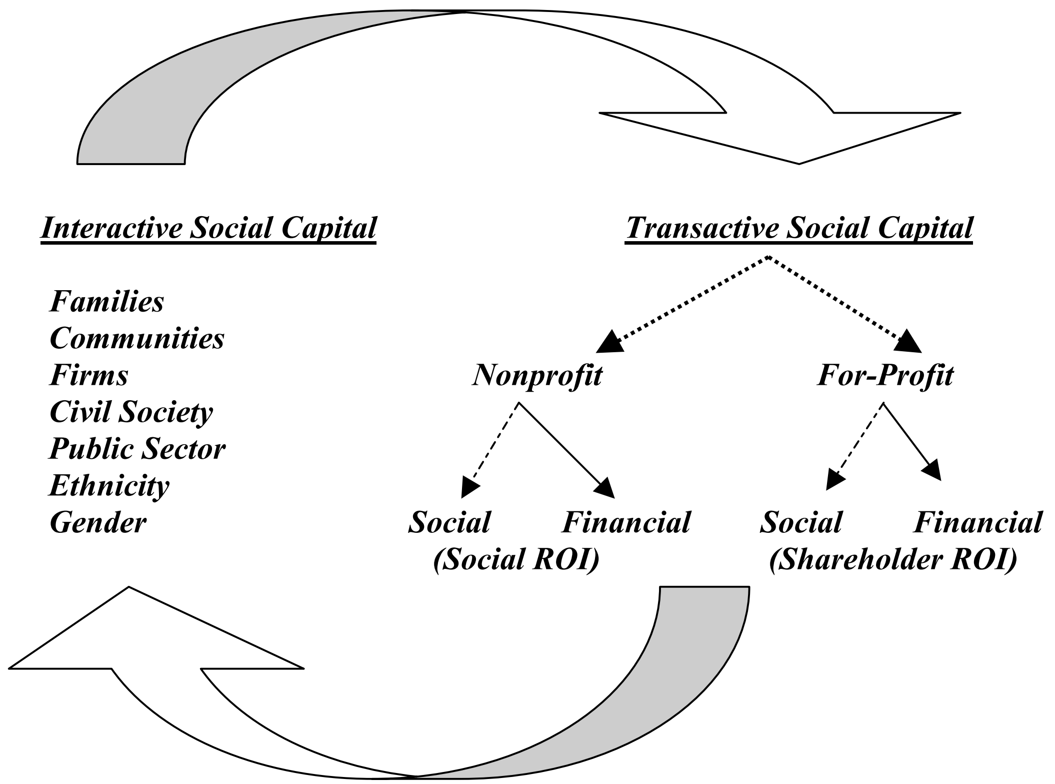
To appreciate fully the power of social capital and the markets within which it functions, it is necessary to explore its ***transactive*** aspect—namely, how social capital is found in the form of financial and social exchange, in both nonprofit and for-profit corporations and those investing in them. *The money that passes between players in the social capital market is the quantitative manifestation of participants' qualitative social values and interactions and may best be thought of as Transactive Social Capital.*[29] The non-monetary, social value created by both nonprofit entities and for-profit corporations at the Transactive level are also a central component of the social capital market cycle's Interactive aspect. Individuals and organizations provide financial support to causes, beliefs and networks of others engaged in work within which a perceived stake or psychic interest is maintained. We act on those beliefs in part, in the form of these social capital market *transactions* and those transactions serve the "bridging" and "binding" functions earlier described. It is, then, the combined effects of both Interactive and Transactive Social Capital that together create the *Integrated Social Capital Market Cycle* (ISCM).

Some say the ISCM Cycle, as seen below, is itself flawed since it does not reflect the reality that financial investments (nonprofit and for-profit) are often made in seeming absence of consideration of social values. Therefore, the "cycle" should be shown as a broken one—for it does not smoothly blend the interactive with the transactive elements as depicted in the graphic. This is, however, exactly the point—while for some the values that inform current investment strategy and practice may be "wrong" (i.e. most traditional investing does not take into consideration social factors that may be effected by the investment), mainstream social and financial investments currently being made do indeed reflect the present dominant value set of society. Traditional definitions of what is considered "on" and "off" the balance sheet are not simply the end product of objective accounting practice, but rather are collective decisions made in the full context of the values that have created the social mores and norms of society.

Society, Public Sector and Gender are really perspectives from which one may look at, and understand the value of, community.

[29] This is not, however, to say that the only way to quantify qualitative social value is through monetizing social impact or related measures. It is to say, simply, that all financial exchange is itself rooted in social frameworks of norms, regulations and mores.

An Integrated Social Capital Market Cycle[30]



Everything flows from this single fact:

We are all connected, one to the other. We are connected to others in the form of <u>Interactive Social Capital</u> and our core community values are expressed by our use of <u>Transactive Social Capital</u>—namely, through the application of financial resources supporting that social order of which we feel we are a part—thereby creating the larger social capital marketplace within which these activities (<u>both</u> transactive and interactive) are continuously executed. All of us operate within this Integrated Social Capital Market Cycle.

The reader will immediately note that this definition of an Integrated Social Capital Market Cycle subsumes the presence and operation of financial and economic systems *within* this larger definition of a market framed with social dynamics and economic activity in balance. The reader's receptivity to this Cycle will rest upon whether financial markets are thought to have their own objective reality (as, for example, do the Laws of Physics) or may instead be viewed as simply the constructs of social perception.

[30] The author thanks James Austin of Harvard Business School for his input and suggestions regarding the design of this social capital market cycle.

We would argue the latter in that financial and capital markets are, in fact, fully imbedded within our social systems for it is this feature which allows those markets to function. As Rosabeth Moss Kanter has observed, "…free market activity works best when there are many other developed social institutions, such as a legal system, a banking system, an educational system producing economic literacy…(B)usiness leaders often cannot take action unless many different institutions are in alignment. Contradictions among institutions—or among claims of social groups surrounding the organization—create conflicts that require organizational attention. Differences in the degree to which institutions support organizational action converts external matters outside of the organization's purview—such as those externalities supposedly handled by the public sector—into internal problems."[31]

Furthermore, James Coleman has also written that "(u)nlike other forms of capital, social capital inheres in the structure of relations between actors and among actors. It is not lodged either in the actors themselves or in physical implements of production….in the present paper, the examples and area of application to which I will direct attention concern social capital as a resource for persons."[32] In this way, social capital is best understood as a resource operating on multiple levels, in a variety of ways to assist the functioning of human society. This paper has addressed the components of social capital interaction that are both predominantly social (interactive) and financial (transactive), however many other areas could be explored as well.

This interplay between social and financial aspects of a shared system is a two-way street of mutual interaction. While financial elements are embedded within social dynamics both act upon each other in an endless interplay of force and function. Regardless of the ultimate source of authority from which financial "market forces" spring, they are experienced by individuals, communities and corporations in a social framework of cultural tradition, rules and regulations governing the flow of financial capital resources in the world today. Whether one believes in "the invisible hand" or not, Alan Greenspan sets monetary policy, hedge funds move currency around the planet on the click of a mouse, and minimum wage levels are set as a result of a collective social process operating within a given value proposition, not simply as the end result of "objective" numerative evaluation alone. For our discussion, we will assume financial processes and social structure are fully embedded, with each informing the other and leave the larger theoretical debates for other papers yet to come.

[31] *The Institutional Perspective on Management*, Rosabeth Moss Kanter, 1997, page 6.
[32] Coleman, pg. S-98.

Definitions of Investment and Return: Implications of the Integrated Social Capital Market Framework for Moving Beyond the Zero-Sum Dissonance

So far in this discussion, we have accepted the traditional definition of social versus financial investment and return. It is logical. It is the common understanding of the world. And it is wrong.

The simple acknowledgement of an Integrated Social Capital Market Cycle wherein both financial and social forces are engaged at parity, presents a real challenge to a traditional understanding of investment and return. The fundamental problem to be addressed is that even a child knows the value of a quarter is the same, yet different, from the value of sitting in the sun while eating a lollipop one has bought with that same quarter. The tension experienced by communities attempting to trade economic vitality for environmental health is the same as that balanced by the conscientious investor pursuing both financial rationality and social sense. And yet historic definitions of investment and return ask us to somehow decide between the two. It is a dissonance that rings in our ears because all know it is a false dichotomy, a *non*-Faustian bargain we are being asked to make, since we know only half the investment is on the table and only half its value under consideration.

The buzzing in our ears is the *Zero-Sum Dissonance* of a traditional and artificial market that only considers and values financial returns. In practice investors and managers don't know how to play in a space that expands the framework to include other than strictly financial metrics. Therefore, being unable to find comfort in the natural middle, players come to be artificially forced to one side or the other. Socially responsible investment funds tout the fact that they make market returns, while being unable to formally track their investment in social value. Formerly "bottom-line" oriented business people make excuses for poor performance or prospects for nonprofit entities since "they are trying to do good" and therefore shouldn't be held to the same financial or managerial disciplines as their for-profit counterparts.

Indeed, one successful, for-profit investor who had launched any number of profitable ventures, upon evaluating a social purpose enterprise, stated that it really didn't matter if those assessing the venture knew it was fairly ill-conceived and had little chance of success, since the social goal was so laudable. And many nonprofit boards have members with solid business and management backgrounds who are often relegated to "rubber-stamp" status, while senior management operates with free reign, to the point where the fundamentals of sound management are overlooked or unaddressed since "it's only a nonprofit." No for-profit investor would approach an investment or ongoing management on those terms, yet somehow in this context it becomes okay to ignore critical signals of potential failure or marginal performance. By the same token, nonprofit managers "know" that a program is good and fight for it even if they suspect the returns and use of resources are marginal at best, since they justify their efforts on the basis of perceived social intent—thereby confusing programmatic intent with documented social impact.

What players in either space are unwilling and unable to accept is the fundamental reality that when two understandings of value exist in the same space a third, unifying framework must be advanced out of which may grow a lexicon of words and numeric analysis capable of capturing the *true* and comprehensive value being created in this radical center—which is to say the center to be found beyond the traditional "left/right" or "social/financial" duality.[33] What is required is a unifying framework that expands the definition of investment and return beyond the historic one of finance and toward a new definition capable of holding a broader understanding of value than that most frequently reflected in traditionally endorsed financial operating ratios. *In truth, the core nature of investment and return is <u>not</u> a trade off between social and financial interest but rather the pursuit of an embedded value proposition composed of both.* As will be addressed in this paper's final section, it is not a question of either/or, but rather both/and.

We need new metrics, new conceptions of the fundamental value proposition that are not simply a "quid pro quo" trade off between two seemingly competing goals perceived to be locked in a zero-sum battle. We must engage in this process because existing frameworks and understandings of both investment and return are not adequate to the reality we all recognize is ultimately the one within which we exist. It will not be simple, but we must address the deficiencies of current approaches. We must advance both a framework for and the tools to track performance of a *Blended Value Proposition (BVP)*. We will focus our closing discussion on the final one, however three steps are called for:

First, we must breed <u>New Century Managers</u> capable of operating simultaneously within the present tension of the double bottom-line while at the same time advancing the new operating systems of the future.

Second, we must build better social <u>management information and tracking systems</u>, while evolving a new set of metrics upon which to assess our progress.

Third, we must consistently advance <u>a Blended Value Proposition</u> that integrates and affirms the greatest maximization of social *and* economic value within a single corporation, investment opportunity or community. And this value proposition must be framed in terms that make sense to all investor stakeholders along the spectrum.

With regard to the first, it is only a matter of time before we begin reaping the rewards of grooming a new managerial class. Whether it is Kauffman Social Enterprise Fellows, Farber Fellows or any number of other programs, young adults are increasingly pursuing careers in for-profit and non-profit corporations exploring the challenges of operating within a BVP. These managers are joined by yet others who, having either made their nest egg or found their original goals lacking, are leaving traditional for-profits. These individuals are taking their skills honed in pursuit of profit and applying them to the creation of profitable social value in ways not seen before in this country.

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[33] One could even advance this to a Third Level, as does Woody Tasch when he states that the task "is to demonstrate that what is generated from the new enterprise creation process is three kinds of returns: financial returns to the investors, social returns to the community and environmental returns to the local ecosystem." (Tasch, 1996).

While many of us have referred to members of this managerial class as "social entrepreneurs" what we describe by the label "New Century Manager" focuses less on "start-up" skills then those required for *sustainable* management of modern corporations. While some may have begun as social entrepreneurs, they must morph into New Century Managers if they are to ultimately survive. They must become mutants of the first order in that they are engaged in more than simply the social application of entrepreneurial skills and practice—they are engaged in what is a fundamentally subversive act of the "knew." At their best, they create new knowledge; they live within a higher level of social and economic integration. They breathe blended gases that would kill traditional managers. They represent a managerial species bred to evolve new metrics and applications of tools previously limited by historic definitions of reality and potential. They are not social entrepreneurs as much as revolutionaries of the Third Way, captains steering the ships of corporate Earth into new and uncharted waters. It is these managers who will lead and guide the successful corporation (whether for-profit or nonprofit) of the new century.

Moving to our second step, we must build information systems and processes capable of measuring the creation of value in this changed context. Various emerging efforts include: The Balanced Scorecard (Kaplan, 1999), Family of Measures (Sawhill, 1999), Social Return on Investment (Emerson, et al, 1996/2000), WebTrack/OASIS (Twersky, 2000) and other types of impact documentation all being advanced as alternative frameworks for tracking performance. Some emphasize managerial performance and others capital performance. But all such efforts are important. We need to understand how different practitioners are assessing the impact of their work and capital. The remaining challenge is that many of these approaches do not move to the next level of understanding, namely an ability to enunciate what the *underlying* value is of the element being measured. *What we are lacking is a common cultural currency to compare relative investments and understand various forms of value creation taking place, whether social, economic, environmental* and so forth. At this point, we know that something is "one," yet don't really know how much a unit of "one" is worth or what its fundamental value is.

For many of those active in the social sector, it has been taken as a virtual given that most elements of social value stand beyond measurement and quantification. Any who advocate the social sector be held to greater accountability and reporting on the progress achieved toward the attainment of societal goals are told in no uncertain terms that, indeed, "some things simply can't be measured and social value is one of them." Such logic defies our own reality.

There are numerous ways to "triangulate" around a given element in order to understand its worth from a variety of perspectives—numeric and otherwise. Efforts to engage in social audits of corporate activity and "redefine" such givens as the basis for calculating a country's gross national product are aimed at understanding the <u>total</u> value proposition. The Aspen Roundtable has produced an impressive set of papers exploring just this point and Redefining Progress is also working in this area. Even the government of Bhutan releases an annual report on that nation's "Gross National Happiness" as part of a strategy for formally addressing what is supposedly "immeasurable."

Numbers and a quantitative approach to understanding social value creation are simply a different language by which we may potentially describe the integrity and worth of the incredible work taking place within the Integrated Social Capital Market. Because so many actors in the Social Sector are not fluent in the language of numeracy, any effort to measure, quantify or describe the creation of social value—any effort to move beyond rhetorical claim to documented fact—is challenged as inappropriate, inaccurate and invalid. And those in the for-profit sector must labor within an accounting and investment framework that doesn't "charge" for those public goods converted to private gain, so despite the good efforts of The London Benchmarking Group and others engaged in social auditing, there are no widely accepted metrics to apply in this context either.

Rather than have a distinct set of units, some of which are measurable and more of which are not, it must first be recognized that *there is a wide array of value creation taking place in the Integrated Social Capital Market,* including those elements that are easily quantifiable and those that really do not lend themselves to existing approaches of measurement. Mark Moore has described this challenge as one requiring an awareness of the multiple dimensions of value as opposed to simply understanding value as the trade-off between "competing measures." (Moore, 1999). Indeed, there is much greater ability to quantify and assess non-financial value creation than we have yet to understand. It is simply a question of becoming as fluent in the language of numbers as the sector is in the language of words and creating the new metrics by which what we have called "Interactive Social Capital" may be understood in the future as well as "Transactive Social Capital" is understood today.

Much of the focus of current discussions relative to the documentation of social impact and measurement founders upon this partial truth that much of the work of the social sector is "beyond quantification." It is a partial truth simply because while various aspects of social valuation stand beyond current metrics, they are beyond existing metrics simply because we have not committed ourselves to the creation of new words and numbers pegged to expressing that which we seek to explain. In short, we have been intellectually lazy and as a result lack the constructs to adequately describe and track that which we ultimately value. In a very real sense we really *do* know the worth of all things and the value of nothing. We track performance of investments in the stock market, yet have little notion of how time invested in sitting with a child will generate what level of return. We can state how many units of service a nonprofit organization delivered, but have little sense of the ultimate value of its having done so. We each know the worth of our financial assets, yet can say little more than "it means something" if we invest time in our community and the people of whom we are a part.

We must evolve a *narrative numeracy* that allows us to speak more deeply about our world—to go beyond the spoken word and compliment it in other ways. The numbers that express SROI are simply symbols, like the letters of the alphabet, that we organize in certain ways to more fully understand our world. A balance sheet, budget or set of financial ratios simply tell a story; they give testimony to our values and priorities, they help express our progress through time, history and the experience of life.

We whine and assume it is beyond us, but to date have not adequately applied ourselves to defining the new language of the Blended Value Proposition. In sum, Social Share Value, Social Equity Ratios and Social Return on Investment are all simply efforts to advance this language capable of more deeply expressing the story of our complex world, community and individual lives. It is in its most basic sense simply our history writ large; in zeros and ones, and A-B-C's, and the collective expression of our collective experience—that of our parents' children, future families and global exploration of value creation. In a very real sense, "the truth is out there" and we have simply to this point not taken adequate steps to meaningfully understand its relevance for our life's work.

The challenge of the future is that of building a new framework for and lexicon of valuation. A framework that helps us see the Whole; A lexicon that may create the narrative numeracy necessary to communicate the full and complete breadth of our social reality in an integrated manner, moving beyond our present inability to track a blended return and communicate the complexity of social and financial value creation.

Resolving the Dissonance:
The Meaning of a Blended Value Proposition and the Nature of Returns

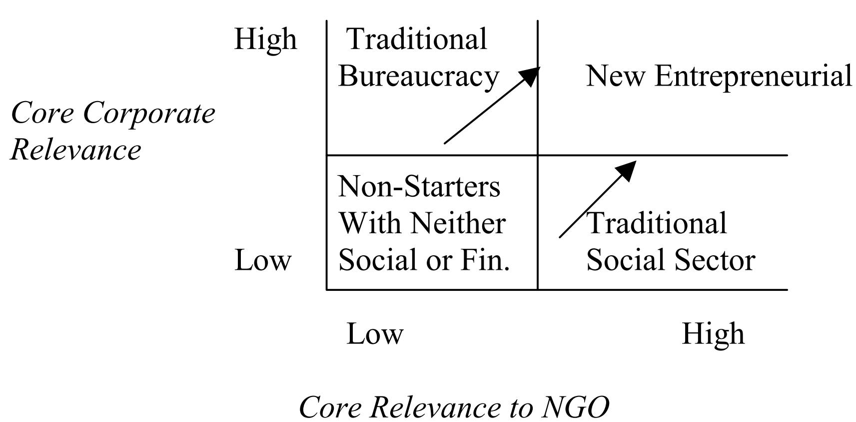
To this point, our discussion of social investment and financial return has operated within the widely held understanding that there is a trade-off between the two. This trade-off is viewed as a zero sum game, wherein to advance toward one is to retreat from the other.

It is no doubt true there are social costs and economic costs, and that each should be tracked. However, it must also be understood that the interaction and trade-off between the two do not take place in a smooth line, one operating in directly inverse relationship to the other. *The issue isn't wealth creation or social change—it is the creation of value, applying resources to the creation of the greatest value possible and the simultaneous pursuit of both economic and social good for investors and investees, as well as the greater community and global Integrated Social Capital Market place.*

How then could we approach this integrated definition of Investment, Return and the core Blended Value Proposition present in the Integrated Social Capital Market?

A helpful tool in discussing value creation issues is a Value Map. A Value Map may be used to track the value migration process from one stage to another, presumably higher value position. For example, the Value Map below was used to describe the migration of future for-profit corporations and social sector corporations from that of traditional to New Entrepreneurial organizations. This map uses as its starting place an X/Y framework that views these two functions of corporate and NGO[34] as being opposite sides of a shared tension. In the New Entrepreneurial quadrant, the value proposition has evolved to a unity of the two that maximizes the value of both organizational types.

Value Map: [35]



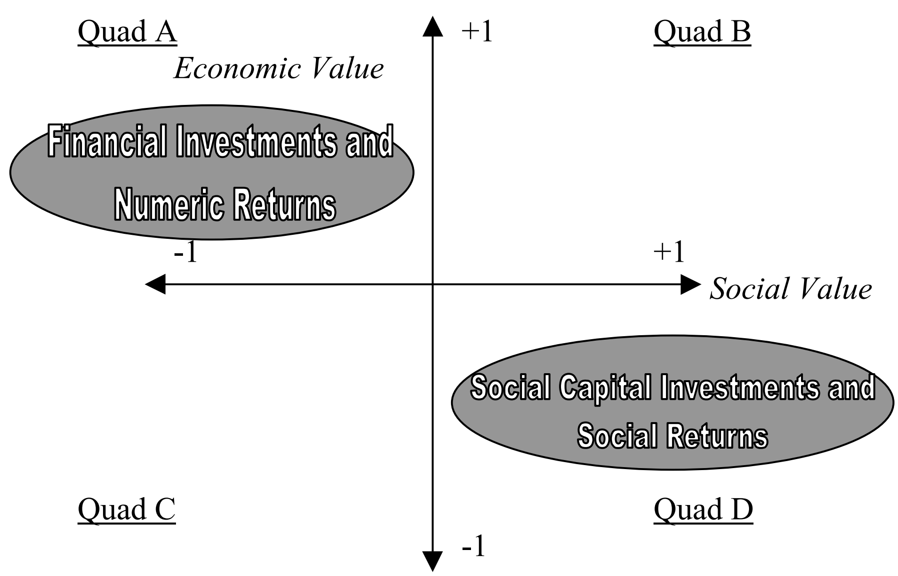
[34] Non-Governmental Organization
[35] Ira Jackson, Fellow, Kennedy School of Government, as presented at March 4, 2000 event on Social Enterprise Conference, Harvard University, and modestly revised by JEE.

Building upon this value map framework, the Exhibit "A Zero-Sum Dissonance," shows how all traditional investments have within them components of both social and financial value. In this example, Quad A represents the higher economic value and Quad D the lower social value of a standard investment opportunity. A traditional analysis would demonstrate that while the social capital investments are viewed as having greater social value, they carry lower financial reward (and therefore lower financial returns to investors). This was earlier referred to as a "profit penalty" that may be tracked along the investment plane. In examining the Value Map assessment of the traditional *Investment Plane* approach to understanding investment and returns, several observations may be made.

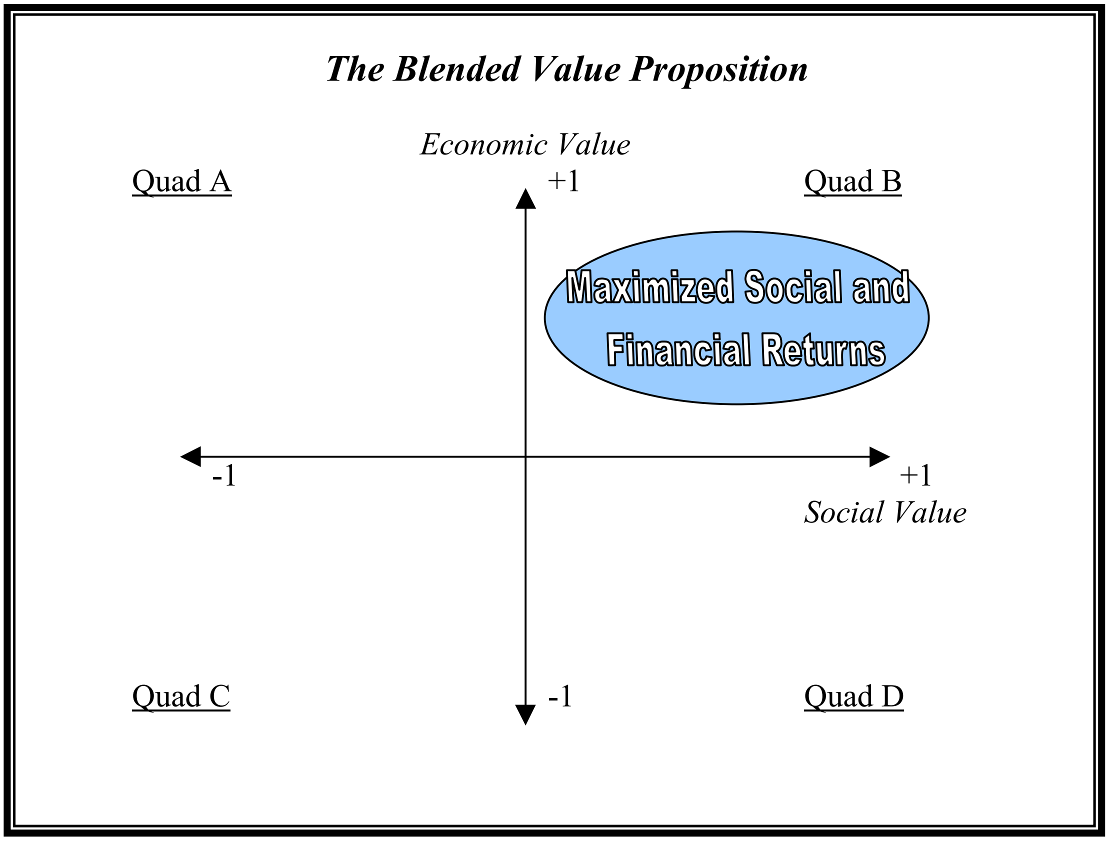
First, it would view the organization's Economic Value as being separate and at odds with its Social Value. While one might attempt to track the two (such as by examining the financials of the corporation and then reading the social audit completed by an outside observer), they are viewed as two separate aspects of the corporation's value proposition.

Second, it is a two-dimensional, linear understanding of value that attempts to "freeze" the analysis under observation. While this may be helpful to a point, it fundamentally undervalues the *transformative* nature of the investment and the dynamic interplay between its social and economic components. It is static. It does not reflect the dynamic interplay of investment and return.

A Zero-Sum Dissonance:
The Traditional Value Proposition



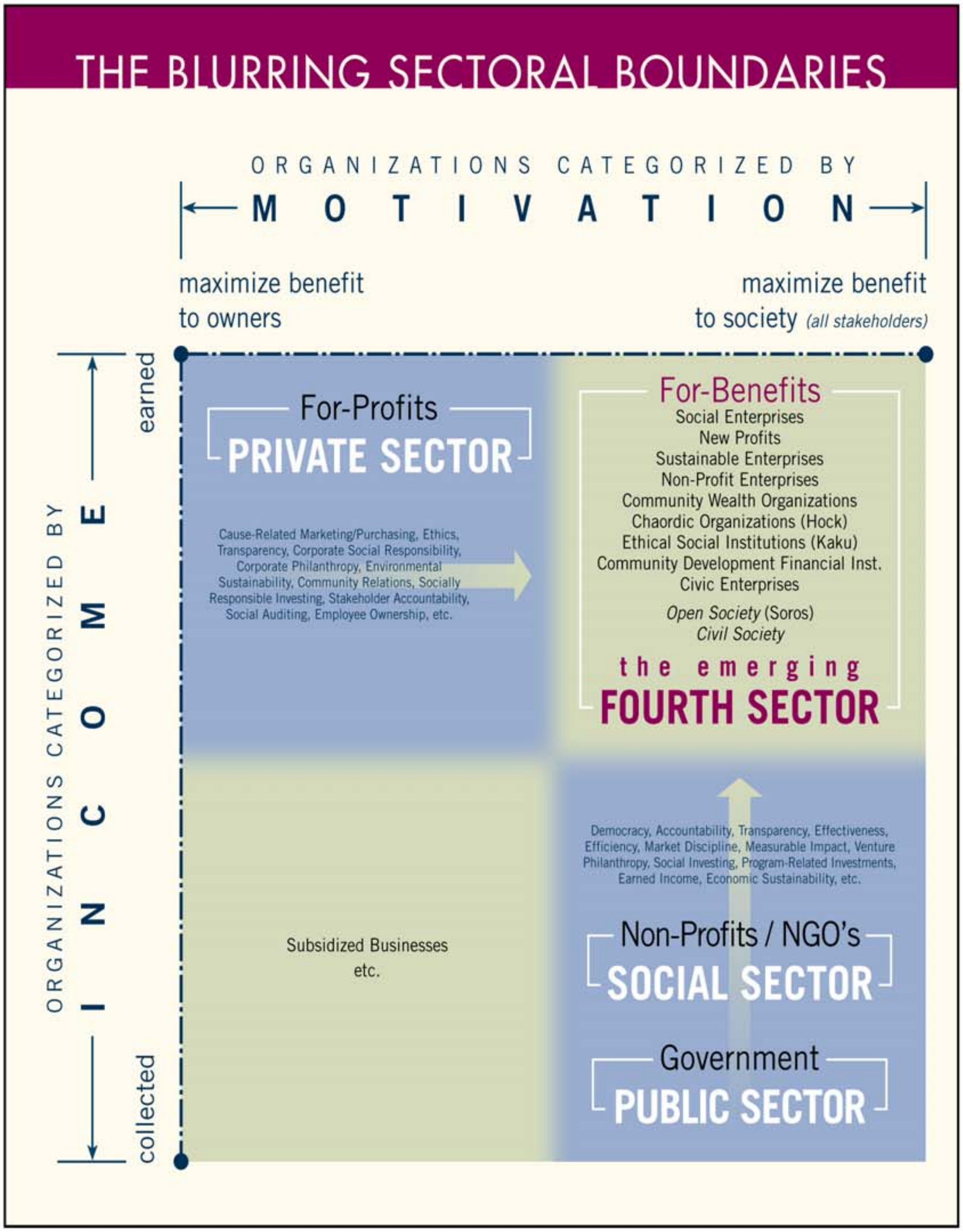
In contrast to a traditional Investment/Return framework with its implicit "sinking economic returns" assumption, a Blended Value Proposition of any given investment understands that *both* functions are <u>integrated</u> and to be fully assessed must be advanced into their highest quadrant, Quad B, wherein they maximize social and financial value creation <u>and</u> shareholder returns. This is depicted below.



This Blended Value Proposition is presented above in a corporate context, but may also be viewed as operating on an aggregated level as an evolving sector—what Heerad Sabeti and others have called "The Emerging Fourth Sector,"[36] a graphic for which will be found on the following page. While we would not use the phrase "blurring" to represent the notion of a Blended Value Proposition, within this Emerging Sector framework, both traditional non-profit and for-profit corporations morph into a fourth dimension of fully blended value creation. This sector represents an integration of a variety of types of capital investment into a new vehicle Sabeti calls a "For-Benefit" corporation. Actually, <u>all</u> corporations (and their investments) generate a newly defined type of return best understood as the Blended ROI. The Blended ROI is the tool by which one assesses the returns generated by the application of social capital in this integrated market place.

The Blended ROI is the focus of the remaining pages of this document.

[36] Graphic courtesy of Fourth Sector Alliance / Muralis Creative



The For-Benefit (Fourth Sector) Organization

1. **Benefit Maximizing:**
   - To "Employees"
   - Through Products/Services
   - Through Expenditures
   - Through Profits
2. **"Earned" Income**
   (economic sustainability: accountability, efficiency, market discipline, measurable impact, self-sufficiency, etc.)
3. **Responsible Practice:**
   - Socially
   - Ethically
   - Environmentally

Defining the Nature of Return in a Blended ROI

As depicted above, a Blended Value orientation at corporate and sectoral levels would argue that the optimum investment is one that acknowledges the reality of blended economic with social value and attempts to maximize returns of both interactive and transactive social capital—with neither separated from the other. The relationship between the various components is fully embedded. As depicted in the original exhibit of the Integrated Social Capital Market Cycle, they are locked in a valuation alchemy wherein social value becomes more than its initial worth and financial returns are understood to be more than numeric reference points along a line.

The challenge may not be how to apply financial, business or economic tools, metrics or strategy to the social sector; or whether it is possible for social value to be created in a commercial vehicle. Rather, the challenge may be our inability to perceive the overarching framework that allows us to enunciate the expansive components of both. *What understanding of returns would advance a unifying theory of the whole?*

A definition of return that does not include both social and financial components is an false bifurcation of the reality in which investors, investees and tertiary stakeholders all live out their lives. It is at best artificial and, at worst, a collective deception of self and society.

A notion of returns absent social components is like an airforce jet, losing a wing in flight—the engine will maintain the craft's forward momentum for a time, but ultimately cannot remain in the sky. The jet falls to the earth in testament to its inherent betrayal of the deeper laws of the universe. Force itself, in this case the solitary engine of commerce alone, is not enough to create sustained value. Societies cannot take flight strictly on the basis of their economic enterprise. It is <u>social</u> commerce, the personal drive of employees to be proud of one's work *and* the web of community connections that permit commercial markets to function and not devolve into financial anarchy, that allow individuals and institutions to pursue the traditional financial returns sought by mainstream financial capital market players. It is the financial imperative *combined with* the framework of socially determined mores, laws and regulations that allow our collective potential as a shared community of interest to be realized. This Blended Value Proposition, then, is what makes possible a Blended ROI.

The reader should take note that this is not some abstract argument for shared returns or the creation of new-age 21st century socialist states. This argument is based on the fact that the ultimate manifestation of the Blended Value Proposition is experienced by individual human beings moving through the day to day reality of their mortal lives. Individuals become wealthy, communities support families and families nurture individuals who may pursue their own best interests. However, that "best interest" can never ultimately be a function of an atomistic perception of life experience or narrowly defined economic value. Even the most alienated, self-centered and ultimately embittered capitalist, while being able to buy the walls with which to isolate himself, cannot enjoy his financial success in social isolation from the Other. He experiences his success in its relative position to that of others in his world and his ability to benefit from being part of a larger Civil Society and relational context of family and friends.

The Blended Value Proposition frames the true definition of return, for the final experience of individual wealth, defined in its most catholic sense, is at one and the same time economic, social and personal. Only in death (as one confronts the Final Return!) is the individual free of the implications of the Integrated Social Capital Market place.

It is the social dynamics of financial capital markets that give numeric, financial returns *ultimate* value. It is the interplay of these complementary forces, the genomic embrace of Interactive Social Capital with Transactive Social Capital, which generates a dynamic tension that, in its totality, creates a "value vortex," a spinning interaction of transactive and interactive social capital. And, as is shown in our final graphic, it is out of this value vortex that the ultimate return, the raison d'être for getting up each day and going to work—the *blended* return on investment—is generated.

The ultimate value treasured by all is not generated as a result of either love or money, but is the outcome of a drive to maximize the greatest potential of both. We all, whether investor or investee, capital player or pawn, are driven by a desire to maximize this blended return for our selves, our families and our investment portfolios—regardless of whether they are presently defined as portfolios of community or commerce.

Implications of a Blended Value Proposition and Return on Investment

While the context of this paper has been that of investment and return, the content actually speaks to the need for a much larger re-definition of value and how it is understood. Future papers will pursue those larger questions and their implication for our ability to pursue a more just, sustainable world where each player, and the communities of which she is a part, is free to achieve her highest potential. For the purposes of this paper, however, we will re-focus upon how a Blended Value Proposition effects our understanding of return on investment. The implications of a BVP are as follows:

<u>Within a BVP Framework, one acknowledges that *all* organizations create blended value</u>. Since all entities are fully integrated, the investor becomes less concerned with the particular legal structure and corporate status of an organization than with its fundamental value generation. A "for-profit versus nonprofit versus hybrid" discussion is only relevant in the degree to which the investor seeks various types of returns for her specific portfolio. Since nonprofit corporations may invest in for-profit subsidiaries and for-profit companies may establish nonprofit organizations to support partisan causes, there is no difference anymore. They are all the same. The periodic debates regarding Unrelated Business Income Tax (a concept that was, in any event, never seriously adhered to in the Social Sector) and related "hot-button" topics are simply archaic holdovers from a prior age. Until such time as a single corporate structure is established by Congress—at which point all divisions will cease to exist—the question is: *What is the fundamental value one is attempting to capture and which legal structure will best facilitate its attainment?*

There is simultaneous interaction of all capital forms. All investments are understood to operate simultaneously in both economic and social realms. There is no "trade off" between the two, but rather a concurrent pursuit of value—both social and financial. Regardless of the equation involved, the two operate together, in concert, at all times. They cannot be separated and considered as two distinct propositions, but are one and the same. As depicted in the final exhibit titled "*Social Capital Performance*," one cannot consider the Interactive Social Capital returns separate and apart from the returns of Transactive Social Capital. All business enterprises have within them a component or function of social value creation and all nonprofit organizations generate a level of economic value and worth. The two are inseparable.

Therefore, all returns generated from investing in this social capital market place are, again, both financial and social. A donor gives to a cause, receiving both psychic reward and monetary tax advantage. A corporation provides on-site childcare, generating employee good will and higher productivity levels. A social service agency provides needed support to those in crisis, creating cost savings for the public sector by virtue of its successful efforts and, at the same time, making a monthly payroll with real dollar economic impact.

The value created will be defined differently based upon the particular time period against which the investment itself is framed. Investors think in terms of the time value of money—and ask: What is the present value of a future dollar? As we explore definitions of both the BVP and Blended ROI, the question of time becomes central to our understanding of value. Many financial instruments (loans, bonds, etc.) are tied to short-term time periods of quarters or years. Such artificial demarcations of reality do not lend themselves to effective use when one is valuing investments whose returns exceed historic definitions of traditional time periods. Depending upon the species within it, the life cycle of a forest is fifty to one hundred and fifty years or more;[37] the time cycle of a community may be defined in terms of generational change and growth; the investment time frame of a child may be a life-time or a day. The challenge of assessing and establishing effective time periods for use in calculating a Blended Return on Investment becomes an important one to our ability to apply such definitions of ROI to any portfolio of investments. We must work to advance an integrated understanding of both natural and financial systems, creating a new framework for appreciating how the two components interact within any given time continuum.

Ultimately, as presented in the final exhibit of this paper, the investment of social and financial capital takes place within a continual and evolving investment time frame. That time frame may, for the purpose of the specific investor, be defined by the terms of the investment itself—whether for a day, a quarter or a year, but for the functioning of the larger Market is viewed as endless. The Integrated Social Capital Market Cycle ebbs and flows but does so as a constant from the day humanity first began to organize itself to the moment just after history closes the book on our collective presence on Earth.

[37] This issue was framed by Connie Best (Pacific Forestland Trust) at a recent Investor's Circle meeting.

The value created within a Blended Value Proposition is, at its core, Transformative Value. All markets may be said to operate in a dynamic fashion with some degree of transformation. However, the ISCM with its BVP and Blended ROI is viewed as continually transforming of itself at the same time that it becomes transformative of its component parts. The ISCM is not static, but dynamic, *evolving* over time. It is *fundamentally* concerned with its ability to generate transformative value. The "energy" represented by the investment is never "lost" to the system or larger capital market, but rather simply takes different forms in its motion. It is a transformative process that progresses as its various component parts interact, influence and change each other. It is through this process that the value-added aspect of any investment comes to be realized by the specific agents involved, the larger market place and society as a whole. The product of these interactions, then, becomes the individual and collective realization of the Blended Value Proposition itself.

Looking at this paper's final exhibit, *Social Capital Performance*, the "time" arrows' direction indicates that all investments are dynamic, moving *through* time, evolving in position relative to other forces at play in the market, and shifting in the relative place of their social and financial components. The social and financial value of any company, nonprofit organization, individual or investment is dynamic, volatile and interconnected with its various component parts.[38]

The structure and form of the Blended ROI "advances" through time, but is essentially non-linear in form. There is a natural tendency to view a Blended ROI as simply an extension of Financial ROI. Yet to assume a linear relationship between the component parts of social capital is to propose a static analysis of what has already been described as a dynamic reality. To accept the previously discussed Investment Plane (a linear, two-dimensional axis) as the true framework for assessing social capital investment and return is overly simplistic. It's like slicing off a piece of sausage, laying the slice down flat on the kitchen table and assuming one is looking at the sausage as a whole. True, it is easiest to operate within this flat world of understanding, to say that for every unit of social value there is a trade-off in exchange for economic value. But to embrace such an understanding of value is to throw our lot with those of old who held fast to the claim of the earth's being flat.

Fractals are the graphic representation of mathematical formulas; "Vibrating strings" the fundamental building block of physics. By extension, Integrated Social Capital Market functioning is best envisioned as interlocking sets of progressively expansive ropes, consisting of braided "DNA ladders" that are themselves a composite of financial and social elements, each building off and contributing to the strength of the other.

As portrayed in the Social Capital Performance graphic, there is no inverse relationship between social and financial returns; they are both present in every activity and investment within the Market. Each is simply the shadow-side of the other—closely intertwined threads of mutually interdependent elements of social/financial value creation, bending in and upon each other as they move within and around themselves.

[38] The author thanks Christine Letts for her observation regarding the transformative nature of philanthropy—upon which the author's narrative regarding the transformative nature of the BVP is based.

The perceived origin and projected future of social capital must itself be re-assessed. The Blended Return on Investment is not restricted to any given period of artificial units of time, but moves around time in the same way it remains continually connected to its past. Social capital is divisible not by its units of analysis, but by its form—a form continually connected in both source and sequence. Social Capital originates in the primordial interactions of community, is manifest in the ongoing expression of value(s) as reflected in monetary and social commitments made in the present time, and is itself ultimately valued in the future based upon the anticipated success of tomorrow's capital agents and market players.

Accordingly, there is no purely "new" investment in this market—all investments build upon and are a part of previous contributions to the collective stock of social capital. It is a stock of capital that has been a part of us and evolving since the first interactions of humanity, a humanity that is, at its very core, social by nature. Social capital can, however, deteriorate if not valued, affirmed and renewed. And it is for this reason we should each seek to support its function in our lives. Social Capital, in connecting us to our selves and community roots us in our past, guides us to our future and provides inherent potential value that makes it a future worth pursuing.

A Blended ROI may not be assigned to any single investor, but is held in common trust. Social capital has various components, some of which may be divided into equity units and assigned to particular investors and others of which can not be held in isolation. The key question to be addressed is not simply whether a given investment generates a financial return to a particular investor. The question is what *forms* of return are generated to what sets of shareholders and stakeholders; and which social/economic functions are fulfilled in what ways for the stakeholder aggregate (i.e. the social stakeholder and consolidated community of interest)? At its most basic level, a Blended ROI is not owned by the individual, but by the common weal in its entirety.

The future will see the introduction of an increasing number of investment vehicles and strategies that pursue the Blended Value Proposition and report on investment performance on the basis of a Blended ROI. We are only at the earliest stages of this development, but it is clear that coming years will witness an increasing number of funds and investment pools created with the direct intent of providing capital to investees on the basis of both social and financial performance. These investments will be assessed on the basis of a Blended ROI.

Historically, those managing the investment portfolio of many foundations have operated in relative isolation from individuals managing the philanthropic investments of those same institutions. As the trustees of these foundations come to understand the intrinsic link between financial investment policy and philanthropic investment policy, the two will be discussed, structured and executed in sync. Many might say that foundations already operate in this manner, however as previously stated, most foundations do not invest their assets with the intent of creating social value and most do not view their grantmaking as part of a larger capital market process. This will change. Smaller, private foundations have been leading the way in experimenting with ways to combine financial and philanthropic investing. For example, The Jessie Smith Noyes Foundation has been engaged in active socially responsible investing of its corpus along with the execution of their philanthropic investment strategies for a number of years.

In addition to this approach to asset management, we will see the introduction of mainstream investment instruments that allow for both principle/interest return *as well as* pursuit of social value. A.G. Edwards & Sons, Inc. (Plymouth, MA) is introducing a "Socially Responsible Equity-Linked Note" that may be issued by nonprofit corporations in search of mainstream capital with which to pursue their social or environmental mission, while providing a competitive financial return. And Japonica Intersectoral (Providence, RI), is developing formal investment offerings that provide investors with fully blended returns based upon specific investment goals. As these and other offerings hit the market they promise to create an entirely new class of "social equity investing" that allows investors to place capital into the market on fully blended terms.[39]

<u>Tracking a Blended Value Proposition requires creation of a Social MIS infrastructure and information dissemination system.</u> If the world is driven simply by financial imperative and the "laws" of economics, than traditional accounting MIS is adequate to our needs. If the world were viewed strictly as an interaction of social players and dynamics, mainstream program evaluation and social science tools would rule the day. In truth, the world is neither economic nor social, but both. The accounting and managerial tools required to understand the functioning of an Integrated Social Capital Market is that of a Social Management Information System (or Social MIS), an evolved infrastructure for identifying, tracking and assigning value to elements at play in this market. This Social MIS will include Socio-Financial Ratios that allow investors to understand and quantify a Blended ROI. To reach this goal, what is ultimately required is a new approach to accounting and capital application.

In a first step toward the design and institutionalization of such accounting systems, The National Centre for Business and Sustainability (NCBS), in partnership with the Manchester Business School (England), is offering a *Foundation Course in Social and Ethical Accounting, Auditing and Reporting*. The course is based on emerging work in this area being done by the Institute of Social and Ethical AccountAbility (ISEA) and is designed around the social performance standard AA1000. The course presents financial, social, ethical, governance and related areas in an effort to assist New Century Managers in the development of the operational skills and accounting practices required to effectively guide the application of capital and other assets in the pursuit of the BVP.[40]

In addition to the creation of new approaches to traditional accounting practice, New Century Managers will also require the ability to design and operate Social MIS able to track the long-term social, economic and other value creation impact of their corporation.

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[39] Papers outlining the strategies and approach of both these efforts will be released in early 2001 by Jed Emerson through Harvard Business School.

[40] Additional information on this course offering may be secured from Rob Lawson at: R.Lawson@NCBE.salford.ac.uk.

The Roberts Enterprise Development Fund (www.redf.org) has worked in partnership with its investees and co-investors[41] to create the OASIS System. Other foundations across the country are investing in the creation of what may be viewed as Social MIS frameworks. These systems build upon traditional approaches to "evaluation," augmenting the tools of the past with the operating infrastructures of the future and providing the base upon which a Blended ROI analysis may one day be conducted.

It is not only the practitioner community that will be required to expand its approach to understanding the long-term value of its activities, but the funding community as well. Appropriate Solutions (Worthington, OH) is exploring the application of ROI concepts to public sector funding. On the foundation and individual donor side, The Roberts Enterprise Development Fund has developed and applied an SROI framework to the management of its own portfolio of investments. By the end of 2000, REDF will post an SROI Operating Template on its web site for free distribution and use by others interested in such analysis. These and other frameworks are not presented as end products. Based upon feedback regarding these systems and the introduction of new ones yet to come, the field will see the continuous evolution of next generation operating systems capable of tracking the Blended ROI.

However, while such efforts are important, the reality is that many foundations and social investors will require benchmarking and other practices be in place before they may effectively make use of an SROI or Blended ROI analysis. To help assist in building the field's work in that area, an independent research fellow is in the final stages of drafting an analysis of commercial sector benchmarking practice, progressive social sector strategies and tactics, and contemporary financial markets analytic tools.[42] Such contributions join the work of Grantmakers for Effective Organizations, the Center for What Works and others involved in building improved approaches to philanthropic practice and performance. These and other efforts will all contribute to philanthropic investors' attempts to more accurately track and document the value created through the application of their funds.

These approaches to assessing social capital returns will increasingly be integrated with mainstream equity tracking systems currently in use or being developed. Whether through modified use of Socrates,[43] MicroEdge.com, The Calvert Groups' Community Investment Profiles, Enfolio.com[44] or other operating systems, social capital investors will demand the ability to research and track portfolio performance on a blended basis—one that allows them to assess their various investments and returns without the artificial

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[41] In addition to the Roberts Foundation, the Charles and Helen Schwab Foundation, the Surdna Foundation and Phalarope Foundation have all contributed to the development of the OASIS System.

[42] The research of Kristina Kazarian will be posted for distribution by December of 2000 at http://unitedu.org/ on their Sector Resource page.

[43] *Socrates* is a socially responsible investment (SRI) service providing stakeholder impact analysis on over 660 publicly traded companies. Over a decade ago, the original Socrates report and system were the vision of Amy Domini. The Domini Fund was among the first SRI funds to out perform "the market" and continues to innovate in the area of SRI.

[44] Enfolio is a portfolio management application service provider, the social investment application of which is in development by iStart Ventures, (Seattle, WA).

separation of those investments as exclusively financial or social. As these systems continue to be improved and evolve, our ability to track the value creation process as a whole will only improve.

In addition to tools to assist us in understanding the fundamental value of what is being measured, *dissemination* of that data becomes critical. The movement away from traditional evaluation and toward viewing evaluation as a form of information management begins to get at this issue within specific organizations. Guidestar.com and other financial "sunshine" initiatives that seek to use the Internet to make baseline financial data available to investors and practitioners is a second step forward, addressing the need for the general public and investor community to be able to access commonly shared data regarding capital structure and performance.

This is a critical issue for at a fundamental level the inability to access information that has both transferability <u>and</u> integrity remains a major "Achilles heel" of those active in the pursuit of social capital returns. As James Coleman observed, "…the concept of social capital allows taking…resources and showing the way they can be combined with other resources to produce different system-level behavior or, in other cases, different outcomes for individuals…it signals to the analyst and to the reader that something of value has been produced for those actors who have this resource available and that the value depends on social organization. *It then becomes a second stage in the analysis to unpack the concept, to discover what components of social organization contribute to the value produced.*" (Coleman, pg. S-101, emphasis added).

Historically, the Social Sector has not aggressively sought to fulfill its accountability to society at large or specific actors within the capital market—whether investor, investee or local community resident. We must rise to this challenge of assuring the integrity and dissemination of financial and social data if we are to succeed in adequately tracking, documenting and analyzing the value proposition of social capital investments and the returns generated by them. This goal must be pursued both by those who receive *and* those who allocate capital resources.

While it should be obvious that the providers of capital must be held to the same standards of accountability as those in receipt of their capital, the sad truth is that this is often overlooked in practice. Many foundations and social investors fail to make full use of annual reports and other avenues available to potentially assist them in sharing their experience and learnings with others. Those foundation evaluations and social impact studies that are conducted often come to be buried within the foundation itself or simply rest comfortably on the shelves of policy analysts. With the advent of the Internet, there is no reason why every foundation should not work to consistently gather and distribute the knowledge in which they have invested. Organizations like MDRC, Public/Private Ventures and hundreds of other practitioner, funder and policy groups should be supported in their efforts to disseminate the information that accrues from their work and the capital invested in supporting it.

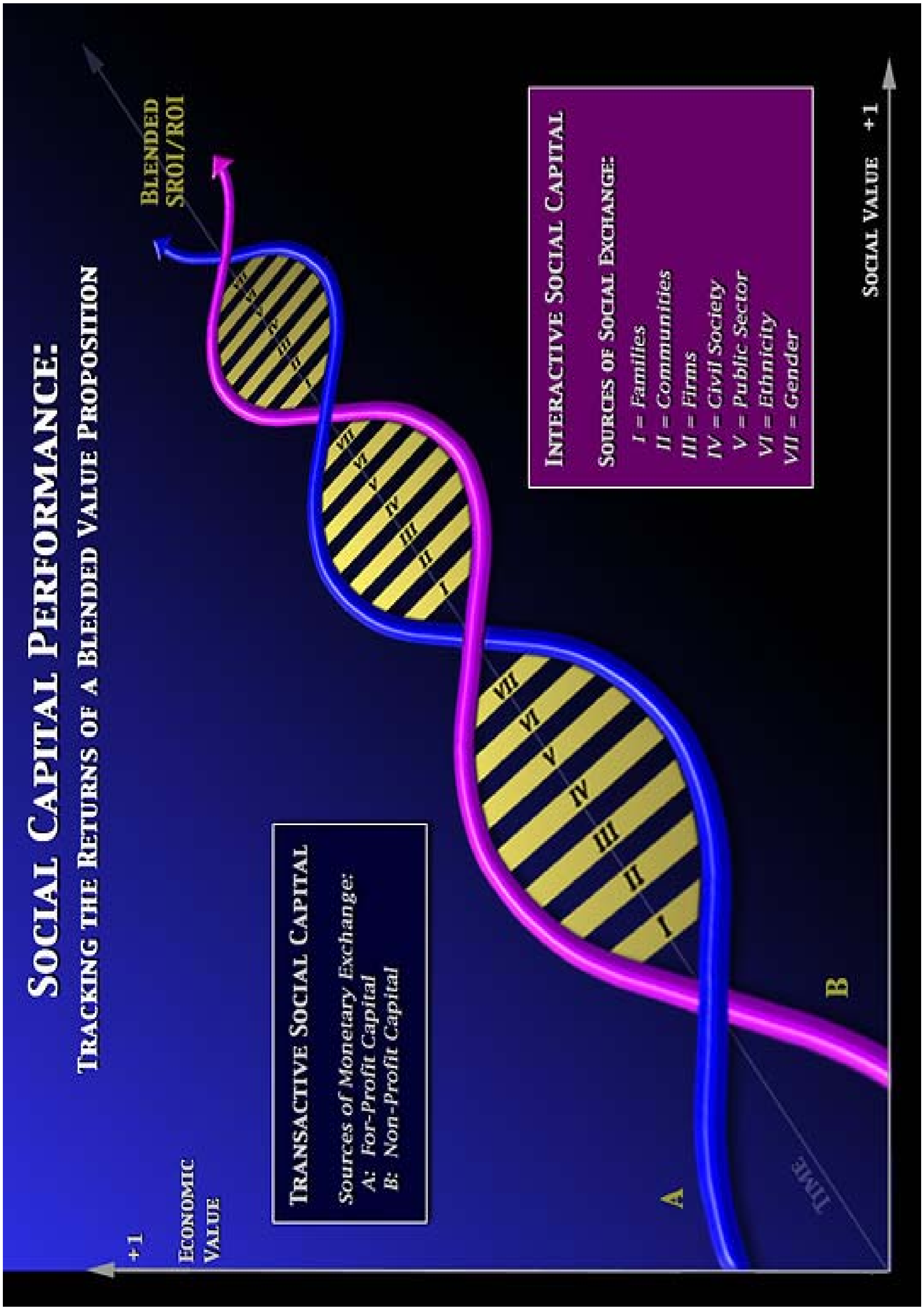
The challenge of living in the Blended Value Proposition. Life in a clearly (though artificially) defined world can be hard, but is in many ways easier than living in pursuit of the Blended Value Proposition. The BVP dictates continual change and innovation, always measuring one's progress against shifting measures of transformative, economic and social valuation. As presented, regardless of how much we would like to assume we are either social or economic, in truth our value is inherently both one and the same and more.[45] The capital we apply is integrated and the returns generated are blended.

However, recognizing this in theory and putting it into operational practice is no small task. Once we embrace the Blended Value Proposition, CEOs must successfully enunciate an inherently more complex vision and have the capacity to lead organizations into as yet uncharted territory. Once we have created the required Social MIS infrastructure, New Century Managers must continually advance, analyze and improve upon that practice. In many ways, effective execution will depend upon an organization's ability to balance sound management with innovation and change.

Fifty years ago, *The Human Side of Enterprise* (McGregor, Columbia University) presented the challenge of organizational change as one of managing within a tension of concern for the creativity of the individual contrasted with the enterprise's need for planning and clarity of organizational objectives. The Stanford Research Institute later framed this dynamic as a three-dimensional cube. And Seward Hiltner (University of Chicago) in his own work suggested that, in truth, it was a question of building organizations along mutually supporting polarities of creativity and structure. The Integrated Social Capital Market, Blended Value Proposition and concept of Blended ROI presented in this paper are the "next stage" constructs for understanding how organizations and the individuals within them must first acknowledge this interplay of forces and, second, undertake the challenge of advancing in practice what we intuit in theory. Learning to live in the Blended Value Proposition and not pretend life is driven strictly by either social *or* financial realities is the next step in this process of understanding how we may use financial resources to expand and sustain the core value of organization, community and individual.

And this remains our greatest challenge…

[45] We have said nothing of spiritual, environmental and other realities!


SOCIAL CAPITAL PERFORMANCE:
TRACKING THE RETURNS OF A BLENDED VALUE PROPOSITION
+1
ECONOMIC VALUE
TRANSACTIVE SOCIAL CAPITAL
Sources of Monetary Exchange:
A: For-Profit Capital
B: Non-Profit Capital
A
B
TIME
BLENDED SROI/ROI
INTERACTIVE SOCIAL CAPITAL
SOURCES OF SOCIAL EXCHANGE:
I = Families
II = Communities
III = Firms
IV = Civil Society
V = Public Sector
VI = Ethnicity
VII = Gender
SOCIAL VALUE +1

Appendix A
Uncharted Ground:
Gaps in the Framework and
Areas of Future Exploration

- ✓ What is the Role of Public Capital, i.e. Government Funding? What are the types of public capital involved? Grants, OCS funding, Tax Incentives, other?

- ✓ What is the role of Government and the impact of regulation?

- ✓ In this "investor" context, where is the nonprofit equivalent of unencumbered capital entrepreneurs invest themselves and have total control over? If all philanthropic investors from individual, direct donors to foundations can make demands regarding their assets, how does the nonprofit develop funds to simply do what they feel is needed—regardless of what the market demands?

- ✓ How do we overcome the challenge of getting companies and nonprofits to:
  Build appropriate MIS
  Start measuring impacts
  Be disciplined in doing so
  Embrace the practice
  Engage in Transparency (this is an issue for investors as well!)

- ✓ Issue of the Politics of Transparency: To date, much of the disclosure by both for-profit and nonprofit corporations has been as a result of governmental regulatory action, often as a result of advocacy by various groups or in response to scandal and crisis. How do we get organizations to embrace the need for investor/investee accountability and transparency of impact analysis as opposed to forcing them to practice it?

- ✓ What are the various types of Social Capital Market Asset Class and how do they tie to/are distinct from Investor Type?

- ✓ What is the interplay of Social Capital on a transnational or global level? Does and, if so, how does Social Capital manifest itself differently in different economic, cultural and other contexts?

- ✓ Transaction Cost issue irrespective of investment—who pays the "set up" cost for creating MIS to track social and other performance and tie that performance back to capital investments? Who pays for the R&D of this field?

- ✓ What are the various investor roles each type of investor plays?

- ✓ What is the role of "social equity"? How is it measured, tracked, valued and traded? How is it assigned to local residents?

Appendix B:[46]

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[46] *The author would like to especially thank Jeff Martini of the Harvard Business School's Information Technology Group for his work on the Social Capital Performance graphic. THANK YOU!!*

[47] All papers cited from The Roberts Foundation are available for download on the Publications Page at: http://www.redf.org/publication/pub_theboxset.html, and from "New Social Entrepreneurs" which is available at the same site for free download.

Origination of Ideas Presented in This Paper:

Since publishing his first papers in 1996, the author has greatly enjoyed the free exchange of ideas with others in the field. The *Social Return On Investment Working Group* was tentatively organized by him in 1999 as a sounding board for a proposed joint exploration of FROI/SROI concepts. The original intent was to provide an opportunity for members of the group to produce a document on the issue and its challenges.

In September of 1999, Jed Emerson circulated an outline with graphs and narrative. This document contained material on how to define the various types of investors in the capital market and approach the issue of social/financial return on investment, among other issues. These ideas will be found in the present paper. Several members of the working group provided the author with feedback on the framework, however the group was not able to produce its own document due to the holidays and related time constraints. Individuals who reviewed the author's initial ideas and overview of SROI/FROI included: *Gary Mulhair* (Consultant to the Morino Institute/President of Community Wealth Ventures) and *Arthur Schmidt* (President, GuideStar Philanthropic Research); along with staff of the Calvert Foundation and Dennis Benson (Principal, Appropriate Solutions), both of whose contributions to this paper have been acknowledged.

The current paper, *The Nature of Returns*, is a Social Enterprise Series working paper.[48] As always the author welcomes all comments and suggestions readers may have for not simply the improvement of this document, but the advancement of the concepts included within it and presently in development. Emerson may be reached at jemerson@hbs.edu.

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[i] The reader should be aware of the definition of types of capital as presented by Paul Hawken, et. al., in the book, *Natural Capitalism*[i]. In their discussion, the authors present four types, including:

- *Human Capital* (in the form of labor, intelligence, culture and organization)
- *Financial Capital* (consisting of cash, investments, and monetary instruments)
- *Manufactured Capital* (including infrastructure, machines, tools and factories)
- *Natural Capital* (made up of resources, living systems, and ecosystem services)

The above definition seems to assume the inclusion of social capital within human capital, however the two are distinct and, as was discussed in this paper, social capital theorists make great effort to distinguish between them.

Future papers by this author will address the connection and interplay between the concept of return on Natural Capital and that of Social and Financial Capital. By not addressing that issue within this document, the author in no way denies the reality of its importance and looks forward to exploring that reality in future papers, however, such a discussion goes beyond the scope of this initial document.

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[48] ***The author would like to thank Black Sabbath, Tool, Godsmack, Rage Against the Machine, Creed, LimpBizkit and others for providing the powerful head-banging musical accompaniment that greatly facilitated his writing multiple drafts of this document late into many a night...***