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Is there room for NGOs in the impact investing ecosystem?

By Adva Saldinger // 12 February 2016

Last fall, two separate groups of NGO representatives had impromptu gatherings at conferences on opposite coasts of the United States to discuss how they might get involved in impact investing. Such keen interest surprised organizers, and it signals a growing desire from international nongovernmental organizations to figure out their approach to investing for development outcomes.

As traditional sources of capital show no signs of growth, as donors are making a push to work with more local organizations, and as impact investing and the role of entrepreneurship in development have gained more attention, INGOs are exploring their options.

Part of that process is a fledgling working group facilitated by the Aspen Network of Development Entrepreneurs and InsideNGO. Already it has 30 members across a spectrum of engagement — from those already doing impact investing to those who are considering what role their organization could play in the emerging ecosystem.

“I think a lot of organizations have a feeling they have to get into this, that it’s a new approach they have to get in on,” said Chris Walker, social innovations director at Mercy Corps.

And there is space for them in the industry, though there’s likely to be some skepticism, both internally at individual INGOs and externally from a broader impact investing community that might question their ability to understand business models, analyze investments and structure deals.

One place where INGOs could step in is the missing middle of financing, the $25,000 to $200,000 or up to $500,000 range of investment, which many impact investors find too risky or too expensive, said Jenny Everett, the deputy director of ANDE. They can also play a role in helping entrepreneurs gain the skills they need to be ready for investments from other investors, she said.

But for many NGOs, working in impact investing will be a new approach and will include the need to either train staff or bring in people with the right skill sets.

“Can they plug some of the gap? If they’re not addressing talent and the missing middle, it’s less exciting; if they fill some of the gaps then it could be a real win,” Everett said.

Why get involved?

The reasons organizations are coming to consider engaging in impact investing are varied — from a natural outgrowth of their model, to an attempt to find new streams of funding as global development finance changes.

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“People see this as a huge disruptor for the sector,” said Stephanie Marienau Turpin, director of social enterprise development at PACT, which launched PACT Ventures in October to to create new partnerships with the private sector, impact investors and social entrepreneurs.

Changes in the NGO sector are part of what is driving many organizations to explore impact investing, especially as traditional donors are giving directly to local partners and beneficiaries, which is forcing NGOs to evaluate their value proposition, she said. Marienau Turpin added that she firmly believes that NGOs still have a role to play, in part as capacity builders, but that it will take a different form.

“It’s been interesting to me that many most active and evangelical groups in the fourth sector are from the private sector,” Marienau Turpin said. “To me that’s backwards because INGOs are built for impact from the start so if we care about creating change we have to be relentlessly focused on creating that change and not so focused on the business model.”

For GOAL, an Irish NGO, which is in the early stages of determining how it might make and structure investments, the decision to consider investing themselves grew out of their work. GOAL uses a market systems approach and, particularly in agriculture and rural livelihoods work, has already been working with social enterprises and linking them to markets, providing some capacity building and helping link them to external investors like Root Capital.

“We have had a very organic movement towards working with the private sector, which brings us to the sort of local conclusion that if we work with businesses and think their success is critical for the overall mission then why not take the next step,” said Henning Ringholz, a global market development and livelihoods adviser for GOAL. “The question is if I believe a company has impact and works to my mission, why don’t I invest myself?”

Choosing a strategy
What’s clear as INGOs are grappling with how to engage and testing different methods is that there are a lot of varied approaches to how they can get involved in impact investing. From creating an internally managed fund to raising the money for a fund managed externally, from big funds and investment sizes to smaller ones, from partnering with existing investors to setting up services to target the market.

One thing that most approaches have in common is a capacity building component that allows the INGO to leverage in-country teams to help support growing social enterprises through training, mentorship and by making connections.

NGOs who use a market systems approach to development seem to be some of the early movers. For some of them, creating funds or doing some impact investing seems like a natural step to add another tool to they way they carry out and finance their work.

That was the case at Oxfam, which when looking at financial inclusion for women found that small women-owned businesses had a hard time getting the capital they needed to grow beyond a microenterprise.

Oxfam wanted to get existing financial institutions to start lending to those women, so it started the Women in Small Enterprise Fund to provide partial loan guarantees to financial institutions to limit their risks and encourage them to lend more money to more women-owned businesses. The fund, which had its first financial close in August 2014 and a second a year later, has raised just under $1 million and has about five loans outstanding, said Mara Bolis, senior adviser for market systems at Oxfam.

At Mercy Corps, staff in the field were regularly seeing innovative solutions and enterprises that delivered impact, so the organization created a social venture fund. The first iteration of the fund was designed to give money to staff who had ideas they wanted to spin out as enterprises, but in May the organization shifted to a more sustainable strategy of investing in existing enterprises.

Focused on Kenya, Uganda, Indonesia and Nepal where Mercy Corps has a presence and the capabilities to support entrepreneurs, the fund is looking for scale at the national or regional level and for companies that put social impacts first.

Their investments at the seed stage will target the pioneer gap with investments of $50,000 or in some cases up to $300,000. The internally managed fund was raised through philanthropic donations and makes investments in equity, convertible notes and may do debt in the future. If the investments are successful, the returns will be reinvested in the fund.

Rather than managing a fund internally, Mennonite Economic Development Associates, or MEDA, which has been investing for decades, has outsourced the management of its Sarona Risk Capital Fund.

Leaders at MEDA recognized that while it has expertise in economic development, they are not themselves investment experts, which is why they have a fund manager who they work with closely as they identify potential investments, said Katie Turner, senior consultant and project manager of SME and Investment at MEDA.

The Sarona Risk Capital Fund, named after MEDA's first investment in the Sarona dairy farm, is managed externally by Sarona Asset Management, a company started by former MEDA employees and then spun off into a private entity.

The risk capital fund is not structured as a formal fund, like many of the others Sarona Asset Management manages, but allows donors to take promissory notes for contributions as small as $1,000 and typically offers low single-digit returns. The fund makes strategic investments alongside projects MEDA is doing and MEDA typically provides support and technical assistance along with the capital.

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While many NGOs have launched or are looking at launching their own funds and making direct investments, PACT is taking a different approach for now.

PACT Ventures is looking at PACT's assets with a private sector outlook and evaluating where the organization is creating the most social impact and what it could do to build a business model around that work and eventually spin off a for-profit entity. The organization is also thinking about how it could build services and products to serve impact investors, possibly by using its networks to help with deal flow or to help get social entrepreneurs ready for investment or to help in tracking social impact.

PACT Ventures has started mapping the entrepreneurship ecosystem in Ukraine and Myanmar and has identified some early opportunities. In Ukraine, PACT has been working with a network of civil society organizations providing HIV and AIDS services and it has decided to test new models to make those businesses sustainable.

Lessons learned

While many organizations are still in the exploratory phases, those who have been through the process of determining how to engage have learned some lessons along the way that can be useful for those in early phases.

The most important thing for INGOs to think about when considering impact investing is to look at it is a means to an end, rather than the outright goal, according to Oxfam's Bolis. While finding ways to bring in and leverage private capital is important, these types of funds don't replace grant-based financing, but rather function alongside it, she added.

It's also important that NGOs "are investing in building infrastructures and architectures that have staying power rather than replacing existing institutions," Bolis said. It can take longer to work in partnership and change existing systems, and it will likely require more patient capital.

NGOs also need to think about what a transition to a business approach and impact investing looks like and the cultural implications for an organization, MEDA's Turner said, adding that the transition has to happen on the board, with senior management and throughout the organization.

"For other organizations looking to get in, think about your current capacity in-house from an investment perspective," she said, adding that if they don't have it they should think through where they can get it — either by hiring new staff or finding partners.

Sharing failures, too, will be an important part of the process, Everett said, adding that she hopes to foster a culture of sharing failures in the working group so that others can learn from them about how to navigate internal structures to determine the right pace and strategy to grow at the right pace.

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The working group will continue to meet, likely quarterly, to continue mapping what each organization is doing and share progress as well as look for ways to collaborate, perhaps in the form of co-investments.

But Bolis thinks NGOs and the working group can also be an important addition to the sector through their advocacy.

“NGOs have a great role to play in supporting impact investors really understanding the issues they purport to take on and to catalyze dialogue between investors and policymakers to push the issues rather than stopping at an individual transaction,” she said.