IMPACT INVESTING (B7360)

FALL 2014

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TEACHING ASSISTANT

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SESSION SCHEDULE

The table below gives the class and session schedule for each module, together with assignment timing. Note that only the first assignment is mandatory—further details on the assignment approach is included in this document. Classes take place on Wednesday evenings during term.

<table>
<thead>
<tr>
<th>Session</th>
<th>Date</th>
<th>Title</th>
<th>Module</th>
<th>Assgn</th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>Wed Oct 29th</td>
<td>Financing Techniques</td>
<td>A</td>
<td>#1</td>
</tr>
<tr>
<td>2</td>
<td>Wed Nov 5th</td>
<td>Hybrid Organizations</td>
<td>A</td>
<td>#2</td>
</tr>
<tr>
<td>3</td>
<td>Wed Nov 12th</td>
<td>Growth Financing</td>
<td>A</td>
<td>#3</td>
</tr>
<tr>
<td>4</td>
<td>Wed Nov 19th</td>
<td>Funds &amp; Infrastructure</td>
<td>B</td>
<td>#4</td>
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<tr>
<td>5</td>
<td>Wed Dec 3rd</td>
<td>Investment Process &amp; Dynamics</td>
<td>B</td>
<td>#5</td>
</tr>
<tr>
<td>6</td>
<td>Wed Dec 10th</td>
<td>Risk &amp; Structuring in Portfolios</td>
<td>B</td>
<td>Pres.</td>
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</tbody>
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REQUIRED COURSE MATERIAL

Each session description lists required and recommended readings in order to participate in the class. Required readings are essential for satisfactory participation in class discussion and completion of Class Assignments and are fully contained within the Readings Packet supplied as part of the course. Recommended readings are suitable for those who wish to delve further into the subject, but information contained therein is not necessary to pass the course overall.

At the end of this document, there is a Reading Guide listing the required readings and reviews for each class session as an aid for class preparation.

Three books are provided to students for the course—these are:

Further books are recommended below for review as part of this course. Each offers in-depth analysis of topics the course will cover and students are encouraged to read each in order to gain a fuller and more in-depth comprehension of the material.


**PREREQUISITES & CONNECTION TO THE CORE**

The learning in this course will build on and extend concepts covered in the following core courses:

**Corporate Finance**  Various elements of company valuation techniques, combining theories around equity valuation as relevant for early-stage companies. Students should consider additional review of value-based investment techniques, particularly that around fundamental analysis, as being of most assistance in acquiring key skills from the course. We will also develop these concepts to understand how investors themselves add extra value beyond just capital.

**Financial Accounting**  A firm understanding of basic accounting principles is necessary for reviewing and analyzing case materials successfully. In discussing non-profit entities, the course will cover specific accounting approaches on net assets (equity) and revenue and expense recognition.

**Leadership Development**  Underpinning the principles of social business is strong leadership in business ethics. In examining the various cases selected for the course, discussion will focus on how the main participants met the leadership challenges and will draw on principles, concepts and learning from the core leadership program. Additionally, early-stage transactions almost always involve intimate negotiations—developing intuition around such interactions is of particular importance in benefiting from course content.

**Strategy Formulation**  The analytical techniques for establishing competitive positioning and strategies for social businesses will be used. Principles of value creation and capture are of specific relevance to social businesses in terms of impact generation.
Students will be expected to have competence in these areas and be able to apply them during the course. Additional use will be made of content from the following core courses:

**Decision Models**  Much of the graded coursework will require analysis of financial information, and students should look to apply techniques in sensitivity analysis and decision-making with risk assessment.

**Managerial Economics**  Early-stage value assessment leans on the concepts of market segmentation and competitive pricing.

**Marketing Strategy**  Comprehensive analysis of social business strategies requires an appreciation of barriers to entry, power of customers/suppliers and other strategic concepts.

**INTRODUCTION & OVERVIEW**

Impact investing has emerged in recent years as a high potential approach to long-term sustainable social and financial value creation. Although its basic business and investment theories do not differ substantially from that typical in established capital markets, there are unique and specific challenges to successfully investing in social ventures.

This finance elective will provide a detailed introduction to this emerging sector of impact investing, equipping students with vital, practitioner-focused skills in the following areas:

- Equity, debt and alternative investment structuring for early- through late-stage social ventures
- Assessment of impact and financial value for companies and investment portfolios
- Legal and governance strategies to preserve mission-focus throughout organizational scale
- Roles of investment funds and philanthropy in building the impact investing marketplace

**CONTENT & STRUCTURE**

This course is suitable for students interested in impact investing as an investor or principal in an impact investing fund. It is also suitable for students wishing to learn about the impact investing space in general. Course material is taught from the perspectives of the company and the investor over the full organizational lifecycle. Course sessions are structured to provide sensible flow to the information and learning.
The content is split into the following two modules:

- **Module A - Business, Investment & Impact Analysis, Sessions 1-3**: Essential concepts for venture financing and specific forms relevant to impact investing; specification and measurement of social impact; financial and impact valuation techniques; governance and legal aspects particular to social ventures from early-stage through scale.

- **Module B - Funds, Portfolios & Infrastructure, Sessions 4-6**: This second module focuses on application of the finance techniques covered previously to the management and operation of investment funds. Creating and managing a portfolio of investment deals through to successful closure and delivery of returns requires a holistic skill-set across legal structuring, risk assessment, and strategic vision—this module aims to integrate these topics into a cohesive approach to deal evaluation and execution.

**MAIN PRINCIPLES**

Over the sessions the course aims to communicate three fundamental principles, which should be considered general guidelines and insights that apply in any activity undertaken in impact investing.

1. Investments into social ventures at early and growth stages are always dictated by the situational needs and objectives of the individual actors present—the entrepreneurs, investors and advisors. In solely applying quantitative financial analysis to venture deals, awareness of how these individuals’ motivations can affect the ultimate terms in a deal is often lost. Recognition and an ability to navigate through this environment is crucial to building a successful career in entrepreneurship or investing.

2. The conflict between financial and social return arises in almost every social venture, regardless of business model. Even if a venture’s revenue opportunity is very closely, or even fully, aligned with its social change strategy, there will inevitably be pressure to prioritize one over the other. A number of current initiatives in legal and governance domains are centered around tackling this challenge.

3. Entrepreneurs frequently focus on capital raising from the very outset of their business—this often tends to cloud the immensely valuable aspect of revenue generation and the advantages it offers for market assessment, product development and improvement in business value. A focus on positive cash generation as early as possible is a highly advisable approach for any entrepreneur.

All students must possess strong financial skills and solid competence in Microsoft Excel. Experience of venture equity and debt financing methods is beneficial, but not essential. By the end of the course, students will have acquired understanding and skills in investment structuring for small and large enterprises, evaluating deal opportunities from financial and social returns perspectives, and structuring and operating impact investment funds.

Focus will be placed on aspects where impact investing is in contrast to typical industry approaches. To that end, a short introduction to financing techniques will be provided at the beginning of the course to basic investment instruments usable for capital financing, but students should recognize that the sessions from that point on will assume solid understanding of those early concepts.

**METHODOLOGY**

The course will use the case method with instructional readings around finance techniques and tools for each class, incorporating multiple preparatory assignments in structuring investments for the case examples. Lecture materials will be used to illustrate key technical concepts, but the majority of class time will be devoted to discussion.
Three to four external speakers will present in specific classes during the course to provide students with in-depth information on real-life examples and focus discussion on specific topics. Information on external speakers will be released as the course progresses.

ASSIGNMENTS & METHOD OF EVALUATION

Students should note that preparation requirements for the course assignments will adhere to the standardized assignment descriptions listed below:

<table>
<thead>
<tr>
<th>Type</th>
<th>Designation</th>
<th>Discussion of Concepts</th>
<th>Preparation of Submission</th>
<th>Grade</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>group/group</td>
<td>Permitted with designated group</td>
<td>By the group</td>
<td>Same grade for each member of the group</td>
</tr>
<tr>
<td>B</td>
<td>group/individual</td>
<td>Permitted with designated group</td>
<td>Individually (No sharing of any portion of the submission)</td>
<td>Individual</td>
</tr>
<tr>
<td>C</td>
<td>individual/individual</td>
<td>None of any kind</td>
<td>Individually</td>
<td>Individual</td>
</tr>
</tbody>
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Students will be graded as described below. Detailed instructions for each of the assignments will be issued in good time before the assignment is due.

At least one week prior to the first session, the Instructor and TA will confirm student allocation to groups for the purposes of the course. Changes may occur to group membership, but only as a result of add/drop—no other changes will be permitted.

- Three class assignments, completed in designated groups. There will be five assignment options available during the course, with the first being mandatory for all groups. The Instructor and TA will confirm which groups are to complete which assignment by the beginning of the first session. The assignments are due immediately before the applicable session begins. Late assignments will not be accepted under any circumstances. Grades for each assignment will be provided within three days following submission. 60%, 20% per assignment, Type A

- Final take-home written exam, performed individually. The exam details and deadline will be given during Session 4. The questions set will focus on either the entrepreneur or investor perspective, and you will be able to select from various cases taught during the course for the subject of your submission. The exam deliverable will be a set number of text pages as a proposal, accompanied by whatever spreadsheets and other materials you feel worthwhile to support your proposal. 40%, Type A

- Whilst not allotted a specific percentage in the course grading structure, individual in-class participation in discussions is considered highly valuable in demonstrating your interest in and aptitude with the course materials. Clearly insightful and complementary contributions to discussion, even if challenging the conclusions being met, are considered of highest value. The value of your contributions may be factored in when assigning your final grade, depending on the proximity of other scores. No formal allocation

COURSE MANAGEMENT & INSTRUCTORS

The course will be delivered through the Canvas course management system. All required readings will be posted online in Canvas for each of the class sessions. All assignments are to be posted by student groups to Canvas folders as advised by the professor or TA.
Students should note that intensive use will be made of Canvas to deliver further optional readings and information relevant to the course content and discussion.

CLASSROOM NORMS & EXPECTATIONS

The convenience and use of laptops and other tablet devices is recognized and permitted for class purposes only. Obvious use of laptops and other smart phone devices for non-class purposes will be rewarded with explicit recognition during class and subsequent noting for class grading purposes.

Sessions will begin and end on time, and prompt attendance and respect of the classroom environment throughout is required.

CLASS TOPICS

The following sections contain the preparation details, readings and other information on each of the class sessions. Each individual session is split into two parts. Both are covered separately— and students should note that each part has specific required reading and possibly assignment goals.

SESSION 1: FINANCING TECHNIQUES

PART 1: CONVERTIBLE, PREFERRED & UNUSUAL SECURITIES

Traditional equity, debt, asset and performance-based financing techniques are fundamental to financing any venture, whether explicitly social or otherwise. However, impact investors have had to adopt specific techniques to counteract current challenges in the sector such as liquidity, secondary markets and eventual exit opportunities.

The Good Capital and Better World Books (BWB) case illustrates one of the earlier impact investment scenarios, with a recently created investment fund looking to secure its first social investment. BWB presents an ideal opportunity, but there are significant challenges around structuring an investment that would meet the objectives of all parties involved. In discussing the case and reviewing actual events that have transpired since, this class will explore those challenges and cover innovative solutions suitable for general adoption in impact investing.

Case

Better World Books

Class Assignment

Class assignment #1 due. Note that this assignment is mandatory for all groups. The assignment will be distributed one week prior to the first course session.

Preparation for Discussion

- Can BWB's business model scale successfully? What adjustments may be necessary at different levels of scale?
- To what degree are BWB’s revenue opportunity and social impact creation aligned? Should the alignment be changed to maximize social impact?
- What strategy should David Murphy and the BWB management team take in negotiating with Good Capital?

Readings - Required

1. George Bene. “Note on Private Equity Deal Structures”. In: Tuck School of Business (2005)
PART 2: MEASURING SOCIAL IMPACT

In the second part of the first session, we will review and discuss the principle of measuring social impact, which presents a substantial challenge, especially when comparing organizations with different business models and in different locations or market sectors. Various standardized approaches are emerging that suit particular asset classes, but the sector is still nascent in developing a coherent methodology.

Robin Hood Foundation's benefit-cost methodology for measuring performance of its grants and determining the effectiveness of its resource allocation is a strong example of a quantitative approach to tackling this sector challenge. In reviewing the BCR, we will also examine analytical and managerial issues around application of a metrics system to an individual company and also across a portfolio. (Note: GIIRS and related methods will be covered in detail in session 5 - this session will not include those particular systems in discussion, please defer comments those systems until that session)

Case

The Robin Hood Foundation

Preparation Questions

- Consider the relationship between outputs, outcomes and eventual impact - how can social metrics appropriately relate impact to an organization's actual activities?

- In a portfolio scenario, how can individual metrics be aggregated into an overall 'fund' performance metric?

- What factors affect the reliability and relevance of the BCR ratio? How do internal and external incentives affect the ratio?

Readings - Required


Readings - Optional

SESSION 2: HYBRID ORGANIZATIONS

PART 1: APPROACHES TO VALUATION

Frequently a topic that generates antagonism between business owner and investor, the issue of financial valuation is particularly subjective. This applies especially to early-stage ventures for which supply of capital can be very limited. Focus on impact returns layers on additional complexity given the difficulty in distilling the many dimensions of perceived impact down to a single metric.

In considering the case of Acumen Fund and Embrace, the class will analyze an enterprise exemplifying an increasing trend in the sector around integration of a non-profit and a for-profit entity into a single business model.

Case

Embrace

Class Assignment

Class assignment #2 due. The assignment will be distributed the day after Session 1.

Preparation Questions

- How can social impact track record and future potential be factored into financial valuation? Should it be factored in?
- What non-financial terms should Embrace and Acumen Fund individually try to negotiate?
- How could the presence of a non-profit entity as a key element of the business model affect an investor’s attitude toward the opportunity?

Readings - Required

1. Tevya Rosenberg. “A Note on Valuation for Venture Capital”. In: Richard Ivey School of Business (2009)


Readings - Optional

- David A. Carpenter. Negotiating an Equity Capital Infusion from Outside Investors. Tech. rep. 2010
PART 2: STRUCTURING HYBRID ORGANIZATIONS

Integration of financial and impact considerations demands innovative approaches to organizational structuring. Impact entrepreneurs have spearheaded the use of hybrid entities, adopting specialized governance and controls. Expanding upon current legislation, industry initiatives have developed new organizational types designed to tackle challenges around managing and financing social ventures.

The nonprofit organization B-Lab has pioneered the creation of benefit corporation legislation, in addition to establishing GIIRS as a ratings and analytics assessment system for social and environmental impact of companies and funds. Various other legislative options have been developed by the wider sector, including the L3C and flexible purpose corporation. Appropriate selection of these corporate structure options for an enterprise and having a vision on how that structure should evolve through scale, is a critical aspect with social ventures. Impact investing needs to accommodate these corporate forms and the resulting implications on financial return and portfolio management.

Case

B-Lab and The New Sector

Preparation Questions

- How does the Benefit Corporation compare with existing legal forms in the US? What are the advantages and disadvantages of creating a new legal form to advance social change?
- What structural evolution is required in the wider marketplace to ensure greater adoption of these new forms of legislation? What challenges exist in acceptance of these new corporate forms by traditional venture investors?
- Could GIIRS be effective across the full range of investment fund types in the social investing space?

Readings - Required


Readings - Optional

- Anurag Gupta. “L3Cs and B Corps: New Corporate Forms Fertilizing the Field Between Traditional For-Profit and Nonprofit Corporations”. In: NYU Journal of Law & Business Vol. 8 (2011)

SESSION 3: STRUCTURING FOR SCALE

PART 1: NAVIGATING OPTIONS FOR GROWTH FINANCING

As ventures and enterprises achieve growth, they experience challenges in determining appropriate strategies to maintain growth, secure financing and attract top human talent. And in social ventures, these challenges must be met whilst also paying constant attention to evolving the business model around social impact goals.
Building upon the themes of financing, impact assessment and organizational structuring from previous sessions, this session will use the Samasouce case as a basis for discussion to examine various issues social ventures face as they evolve.

Case
Samasource: Give Work, Not Aid

Class Assignment
Class assignment #3 due. The assignment will be distributed the day after Session 2.

Preparation Questions

- How should Samasource fund their growth going forward? Should the company create separate for-profit and non-profit businesses? Why?
- How can Samasource manage improvement and learning in their delivery centers going forward?
- How can Samasource continue to acquire top talent? As Leila, what would be your recruiting pitch to potential employees?

Readings - Required

Readings - Optional

PART 2: SCALING SOLUTIONS

The design and strength of structures are tested most at extremes, and in business this extreme often comes through scale. The solutions used in integrating financial and impact returns present particular hurdles in reaching long-term sustainability for social ventures. Public markets have a particular role to play as a common source of liquidity for early-stage venture investors, however the dynamics around investor behavior change dramatically with that transition.

The detailed A-List Education case will be used to illustrate these challenges from the perspective of an organization that has established a strong baseline for operations and seeks to expand to scale used a hybrid revenue and financing strategy. We will also review the basic structural elements of the Social Impact Bond and current material around its success and potential.
Case(s)

A-List Education Case materials will be provided electronically

Preparation Questions

• Given the options available, what financing strategy would you recommend for A-List Education and why?

• What aspects of the business model, if any, help to categorize A-List Education as a social enterprise?

Readings - Required


Readings - Optional


• Antone Johnson. “Structures, Second-Class Investor Citizens: Facebook IPO and Dual-Class Equity”. In: Gust.com (2012)

SESSION 4: FUNDS & INFRASTRUCTURE

PART 1: DEAL-MAKING FROM FUNDS

Impact investing involves a wide spectrum of investment funds, from angel to venture to growth capital. At all levels, funds can define their priority as impact-first or returns-first with consequent effect on their incentives. And similar to traditional markets, impact intermediaries are critical in facilitating the placement of capital.

Continuing the theme of assessing deal examples in the social venture space, we review Pacific Community Ventures’ investment into Galaxy Desserts and aspects around investment fund structuring, operations and incentives.

Case

Pacific Community Ventures and Galaxy Desserts

Class Assignment

Class assignment #4 due. The assignment will be distributed the day after Session 3.

Preparation Questions

• Consider the economics of PCV’s funds from an operations and management standpoint? Do you think these are reasonable? What comparisons can you make with the wider venture capital marketplace?

• How effective do you think PCV’s social return metrics are? How would focus on social values and mission be affected as Galaxy Desserts scales?
PART 2: FUND STRUCTURING & RAISING

Structuring and governance of investment funds is of particular importance in the impact sector, where the integration of financial and social outcome goals often requires specific design elements to ensure adherence to those goals and principles.

In the second half of this session, we’ll review a standard LP agreement and other investment fund design examples from the impact sector to understand how organizations have approached these challenges. Additional in-class readings will be issued to supplement those listed below.

Case

Example LP Agreement, Appendix A, Summary of Principal Terms Materials will be provided electronically

Readings - Required


Readings - Optional

- Example LP Agreement, Appendix D, Limited Partnership Agreement

SESSION 5: INVESTMENT PROCESS & DYNAMICS

PART 1: SOURCING & EXECUTING DEALS

The traditional venture sector has demonstrated the true value of a vibrant and active ecosystem around entrepreneurial vision and business creation—Y-Combinator and Techstars being excellent examples. This same dynamic is prevalent and perhaps even more crucial in the impact sector: With investment returns yet to cover operational costs of
early-stage funds, incubators and accelerators provide fundamental value to the overall impact investing industry in generating strong deal-flow.

A robust and well-managed deal evaluation and execution process, in addition to a clear investment mandate, is fundamental in the success of a venture fund. In this class, discussion will use the SJF Ventures & Ryla Teleservices case to examine the process by which ventures funds identify and evaluate deal flow.

Case

SJF Ventures & Ryla Teleservices

Class Assignment

Class assignment #5 due. The assignment will be distributed the day after Session 4.

Preparation Questions

- What unique challenges did Ryla’s service-based model create for SJF in valuing the enterprise?
- In structuring the round, how could SJF have better tackled the issues of capital availability?

Readings - Required


Readings - Optional


PART 2: DEAL CHALLENGES

Managing an investment portfolio involves dealing with the inevitable issues around founder, investor and partner relationships and formulating a strategy to mitigate risks around the potential for success and eventual returns.

In this session, we will examine investment terms that provide benefit to the investor in managing a portfolio investment and control in delivering required performance against fund objectives, and specific terms that suit social ventures. Open discussion will also consider how the strategies of early-stage ventures evolve as the business grows, and how investors can deal with that evolution. In addition, we will review alternative strategies for entrepreneurs to actually raising investment capital—these equity-efficient options are often overlooked in the race to raise capital.

Case

Biolite - The Little Stove That Could

Preparation Questions

- From the perspective of a potential investor, what would your recommendation be on an investment in Biolite? Why?
SESSION 6: RISK & STRUCTURING IN PORTFOLIOS

Portfolio strategies in impact investing have to consider multiple elements—individual fund returns, in effect equating to sustainability of the fund itself, and the greater goal of creating wider-scale change to achieve maximum impact possible. Impact portfolio funds also require investors to aggregate around a common fund mandate, integrating both financial and impact return goals. Yet the diversity of investors desired impact returns can create major challenges in this respect.

In our final session we will examine in detail the case of E+Co and Persistent Energy Partners, a fascinating example of the opportunities and challenges in creating and scaling a social enterprise that manages a complex portfolio of international investments.

Case

E+Co: A View from the Boardroom

Preparation Questions

- What are the risks with deal evaluation in E+Co adopting a self-assessment approach with opportunities?
- E+Co’s strategy mixed very early-stage with later stage growth investments - why was this approach taken?

Readings - Required


Readings - Optional