Title: “The opportunity for Foundations to engage with social investment: The Case of the European Institute of Peace”

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Abstract

This thesis sets out to analyse the strategic challenges that foundations in Europe face and the opportunity social investment presents to them as a new tool to achieve their missions. In particular, it explores how operating foundations such as the European Institute of Peace (EIP) can engage with impact investing through the creation of an internal investment fund.

This analysis is particularly important because social investment is a growing sector with an immense potential to create impact and foundations can play a key role in its development. Social investment adds a third dimension, impact, to the traditional two-dimensional investment that balances risk and return. It has the potential to attract capital from diverse types of investors to solve complex societal challenges. Moreover, there is limited academic literature available about the experience of European foundations within the social investment sector. This thesis aims at closing that gap, by reviewing emerging literature and sharing examples of forerunning organizations in this field. This thesis studies how foundations have been engaging with social investment and contributing to its development in a variety of ways, including exploring it as a means to achieve their missions.

More specifically, the analysis of this thesis is targeted towards a particular foundation – EIP, where I currently work and aim to contribute to its development with this thesis. This thesis is particularly important for EIP because it addresses the foundation’s challenges and ambitions and analyses how social investment could be an opportunity for the development of EIP and of conflict prevention in general.

This thesis is relevant for a diverse audience, including European foundations interested in engaging with social investment, other operational organisations that, like EIP, have no endowment funds, and any kind of organisation working in the field of conflict prevention.

This study proposes that operational foundations can engage with social investment and leverage their expertise through the creation of a social investment fund. It then details how such a fund can be developed with the EIP. However, it remains to be studied other solutions that could address EIP challenges and ambitions and other ways in which EIP could engage with social investment.

List of Abbreviations

CEO	Chief Executive Officer
CEP	Center for Effective Philanthropy
CPF	Centro Português de Fundações
CSO	Civil Society Organisation
CTT	Charity Technology Trust
DAFNE	Donors and Foundations Networks in Europe
DIB	Development Impact Bonds
DFI	Development Finance Institutions
EEAS	European External Action Service
EFC	European Foundation Centre
EIP	European Institute of Peace
EU	European Union
EVPA	European Venture Philanthropy Association
FAWE	Forum for African Women Educationalists
FFP	Fund For Peace
GIIN	Global Impact Investing Network
GPI	Global Peace Index
HD	Centre for Humanitarian Dialogue
HNWI	High Net Worth Individual
IcSP	Instrument contributing to Stability and Peace
IRIS	Impact Reporting and Investment Standards
IRR	Internal Rate of Return
MDIF	Media Development Investment Fund
MDLF	Media Development Loans Fund
MRI	Mission Related Investment

NEF	Network of European Foundations
NGO	Non-Government Organisations
ODA	Official Development Assistance
PBF	United Nations Peace Building Fund
PRI	Program Related Investments
PRISM	Prevention of conflicts, Rule of law/SSR, Integrated approach, Stabilisation and Mediation
SDG	Sustainable Development Goals
SI	Social Investment
SIDA	Swedish International Development Cooperation Agency
SIB	Social Impact Bonds
SPO	Social Purpose Organisation
TIA	Total Impact Approach
UK	United Kingdom
US	United States
USIP	United States Institute of Peace
VP	Venture Philanthropy
VPO	Venture Philanthropy Organisation

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1 Introduction

The European Institute of Peace (EIP) was created in Belgium in 2014 as a public-benefit foundation. EIP's mission is to contribute to the global peace agenda of the European Union through mediation and informal dialogue. So far, EIP has been a pure operating foundation, depending on grants from members and donors to develop its projects. The foundation's financial situation is not sustainable in the medium-term and therefore its directors are looking for additional sources of funding and other ways to achieve the foundation's mission.

To understand the framework in which European public-benefit foundations, such as EIP, operate it was important to do a literature review on foundations in Europe, including how they have evolved, the diversity of foundations that exist within Europe and the different definitions they may have. The fact that there is no single legal definition of a foundation accepted in all European countries was one of the challenges faced when trying to collect data about European foundations as a group. This factor also limits cross-border activities of foundations and the European Foundation Statute is mentioned as a possible solution.

The study of the trends influencing the development of foundations in Europe identified social investment as one of the main trends regarding foundations' investments. The ensuing literature review intended to explore the concept and evolution of the social investment sector and, in particular, how foundations in Europe are engaging and contributing to its development. As often as possible, examples of forerunning organizations using social investment are included.

This thesis suggests the creation of a social investment fund as a means for operating foundations with no endowment funds, such as EIP, to engage with social investment. Specifically, it analysis social investment as an opportunity for EIP to grow and achieve its mission, contributing to the development of conflict prevention. The suggestion to have conflict prevention as the fund's focus resulted from six interviews held with EIP staff and external peace promotion experts, a review of available literature on the peace promotion field, and on EIP's and EU's priorities. This thematic guarantees the alignment between the social investment fund and EIP's mission, current work and growing ambitions. Moreover, it has the potential to fill current funding gaps and contribute to the development of local conflict prevention projects.

The last two sections of the thesis focus on the investment strategy of a social investment fund in conflict prevention. The main components that define any investment strategy are discussed in the specific context of investing in the conflict prevention field. Moreover, the thesis includes practical suggestions for EIP's fund regarding each of these components, with interviews held giving valuable insights on the field of conflict prevention and EU's priorities and funding structure. In addition, these sections help to clarify how social investment could play a part in supporting conflict prevention projects.

2 Foundations and Social investment

2.1. Foundations in Europe – history and types

This thesis starts by analysing the context in which foundations in Europe operate, exploring their evolution and diversity, as well as the attempts made to harmonize them across European countries. This contextualization is important to familiarize the reader with the different foundation types and to be able to identify under which categories EIP falls.

The fact that there is more literature about US than European philanthropy could lead some to think that American foundations are pioneers and have served as examples to be followed by the European ones. However, the reality is that the context in which they operate is so different that it makes it difficult to compare them.

The limited literature about European foundations is also due to the different national rules that govern foundations in Europe, which makes it more difficult to elaborate on studies and statistics about European foundations as a group.

In addition, the activities of European foundations are traditionally low profile, which contributes more often than not to the ignorance about their achievements and advocacy work. The *EUROFI Study - Portugal Country Report of 2015*, for example, states that "foundations in Portugal could benefit themselves and the country with increased investment in communicating what they do, and the impact of their activities".[1]

The rich diversity within European foundations is a consequence of the various models of civil society, the numerous legal frameworks and the different role the state plays in each country. Foundations in Europe have evolved in various ways, accompanying, among other things, the progress of the separation between religion and state.[2]

The book *Philanthropy in Europe: A rich past, a promising future*, for example, refers to four different models of civil society organizations (CSO) defining the role foundations play in each of them: Anglo-Saxon (United States and the United Kingdom), Rhine (Belgium, Germany and the Netherlands), Latin/Mediterranean and Scandinavian. [3] These models influence the role foundations play in the society, depending on: their relationships with the government and church; the fiscal and legal climate in which they operate and that influences donations; and how volunteerism is perceived. A summary of these models can be found in Annex 1.

In some European countries, people are expected to contribute to the common welfare through the payment of taxes to the government. The government then becomes the main body responsible for

[1] Franco, R. (2015). *EUROFI Study European Foundations for Research and Innovation-Portugal Country Report.* Luxembourg: Publications Office of the European Union
[2] MacDonald, N. and de Borms, L. (2008). *Philanthropy in Europe: A rich past, a promising future*. Alliance Publishing Trust
[3] *Ibid.*

solving the social challenges, leaving foundations to play a role perceived as very small and scattered. This is, however, not the role that foundations have historically played in Europe.[4]

Despite the differences between them, history proves that "foundations have played an important role in the development and strengthening of European societies".[5] And they have been doing so using a diverse range of methodologies complementary to grant making, such as, among others, the advocacy and development of scientific and cultural centres.

The term 'foundation' can have different meanings and requirements in each of the European countries because there is no legal definition of 'foundation' in Europe.[6] This affects the development of foundations' cross-border activities and since 2000 has led to several initiatives to study and draft a European Foundation Statute that would be an additional supranational legal framework for foundations. One of these initiatives was the study about the feasibility of a European Foundation Statute ordered by the European Commission in 2007 and delivered in November 2008[7]. The study included an analysis of the existing barriers for cross-border activities, how these barriers could be reduced or eliminated and what would be the effects of such actions on foundations and their missions. This study identified the European Foundations sector as a major economic force, traditionally underestimated and probably having a higher economic weight in assets and expenditures than US Foundations.

When developing cross-border activities, foundations face several types of barriers, from legal, to psychological and language, among others[8]. The European Foundation Statute would be mainly a legal instrument that would help foundations operating in Europe overcome the legal barriers. However, the major obstacles these initiatives have found are the existing differences between national laws ruling foundations and the unwillingness of the countries to harmonize them.[9]

Currently in Europe, foundations can be defined according to three dimensions: their operating model; the source of their funding; and their purpose. It is worth mentioning that not all these definitions have legal implications and that they may have different interpretations in each country, due to the lack of harmonization mentioned before.

Foundations can be defined as operating or grant-making, depending on how they operate to achieve their mission. The **operating** foundations primarily develop their own programs in order to achieve their mission, and may also provide grants to other organizations. The non-operational or **grant-making** foundations mostly make grants to other organizations that develop programs aligned with their mission. Although usually both types of foundation exist in each country, the ratio between the

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[4] MacDonald, *loc. cit.*

[5] *Ibid.*

[6] European Foundation Centre (2015). *Comparative highlights of foundation laws: the operating environment for foundations in Europe*. European Foundation Centre. http://www.efc.be/publication/comparative-highlights-of-foundation-laws-the-operating-environment-for-foundations-in-europe-2011/, accessed 10.03.2017

[7] Hopt, K. J., von Hippel, T., Anheier, H. K., Then, V., Ebke, W., Reimer, E., & Vahlpahl, T. (2009). *Feasibility Study on a European Foundation Statute: Final report*. http://ec.europa.eu/internal_market/company/docs/eufoundation/feasibilitystudy_en.pdf, accessed 03.03.2017

[8] *Ibid.*

[9] *Ibid.*

two types of foundations varies. However, in European countries, the national foundations' sphere tends to be dominated by operating foundations as opposed to US, where grant-making foundations are more common. [10] As per DAFNE, there is a limited number of countries in Europe where grant-making is the main activity of public benefit foundation, Ireland and the United Kingdom being among those. [11] It is worth mentioning that, although foundations are either mainly grant-makers or operating, it is possible that they develop both activities as their core to achieve their mission.

In the US, depending on the source of their funds, foundations can be also defined as private or public. Corporate foundations tend to be private and community foundations tend to be public foundations in terms of the source of their funds.

Public foundations, also named public charities, generally derive their funding or support primarily from the general public, receiving grants from individuals, government, and private foundations.[12]

In general terms, private foundations are charitable organizations that do not qualify as public charities. A **private** foundation may also be referred to as an independent foundation, and it is defined as "a nongovernmental, non-profit organization usually funded from a single source, such as an individual, family or corporation"[13], instead of being funded by the general public. Even though contributions to private foundations technically are tax deductible, many of these non-profits do not accept donations. In US the private foundations are required by law to distribute a certain percentage of their endowment, even though this pay-out rule does not exist in European countries, some countries do, however, "require that foundations spend a certain amount or proportion of their income during a specified period".[14]

A **corporate** foundation is "a private foundation that derives its grant making funds primarily from the contributions of a profit-making business"[15]. Typically, these foundations operate under the same regulations as private foundations.[16] Robert Bosch Stiftung is an example of a European corporate foundation and is number four in the list of the Top Ten Wealthiest European Foundations.[17] As in the case of Robert Bosch Stifung, corporate foundations are usually born from the philanthropical vision of the company's founder and continue to operate, even after his/her death, due to the recurring funds coming from the profits made by the running business.

A **community** foundation is "an independent organization operating in a given geographic area which, over time, builds up an endowment contributed from many donors, provides services to those donors, makes grants and undertakes community leadership activities to address a wide variety of current and

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[10] Hopt, K. J., von Hippel, T., Anheier, H. K., Then, V., Ebke, W., Reimer, E., & Vahlpahl, T. (2009). *Annex H- Types of Foundations – Feasibility Study on a European Foundation Statute.*
[11] McGill, LT. (2016). *Public Benefit Foundations Report 2016*. Foundation Center https://dafne-online.eu/wp-content/uploads/2016/10/PBF-Report-2016-9-30-16.pdf, accessed 07.10.2017
[12] Fritz, J. (2016) The History and Types of Foundations. The Balance. https://www.thebalance.com/the-history-and-types-of-foundations-2502444, accessed 10.03.2017
[13] *Ibid.*
[14] European Foundation Centre, *Comparative highlights of foundation laws*, *loc. cit.*
[15] Fritz, *loc. cit.*
[16] Hopt, *Annex H- Types of Foundations*, *loc. cit.*
[17] Funds For NGO's, https://www.fundsforngos.org/article-contributions/top-ten-wealthiest-european-foundations/, accessed 19.03.2017

long-term needs in its service area."[18] Community foundations are originally from the US and it was only during the 1980's that the concept spread to Europe. In Portugal, Fundação Côa Parque is an example of a community foundation. It was funded in 2011 by IGESPAR, ARHNorte, the Regional Tourism Organization of Douro, the Côa Valley Association of Municipalities and the Municipality of Vila Nova de Foz Côa. The foundation's main focus is the protection, conservation, research and divulgation of the Rock Art and other archaeological, scenic, cultural and natural heritage in the area of the Côa Valley Archaeological Park.

Foundations can also be defined, according to their purpose, as private benefit or public benefit foundations. This definition has legal consequences. According to the EFC, "**private benefit foundations** are those that pursue private purposes, such as the advancement of one family, relatives of the founder, trust funds for the education of the founder's children, etc."[19]

The term **public benefit foundation** typically refers to private, independent organisations whose activities are intended to benefit the public. To qualify as a "public benefit foundation", which is a legal status with tax implications in some European countries, an organisation must expend its funds for educational, cultural, religious, social or other public benefit purposes. As per the data collected by the Donors and Foundations Networks in Europe (DAFNE) in 2016 there were more than 147,000 "public-benefit foundations" in Europe, with combined annual expenditures of nearly 60 billion euros.[20]

Not all European countries have both private and public benefit foundations. According to the 2016 Foundations Center report, in most of the DAFNE members (14 out of 24) there are both types of foundations.[21] However, in 10 of the 24 DAFNE countries, there are only public benefit foundations – Finland, France, Ireland, Poland, Portugal, Russia, Slokavia, Spain, and the United Kingdom.

In Portugal, for example, the 'Lei Quadro' defines a foundation as: a legal person that is not-for-profit, that holds sufficient patrimony, and that is irrevocably allocated to the prosecution of a social interest (art. 3. n.1 - LQ). Organisations that do not pursue a social interest cannot, therefore, be considered foundations.

Despite the differences across European countries, the generally accepted definition of foundation in a diverse range of countries is the one of public-benefit foundation.[22]

All the models and definitions mentioned above are important not only to demonstration the variety and complexity of foundations in Europe, but also to set-up a common understanding of these definitions, which will often be used in this thesis. It also promotes a better understanding of what type of foundation EIP is.

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[18] Hopt, *Annex H- Types of Foundations*, *loc. cit.*
[19] European Foundation Centre, *Comparative highlights of foundation laws*, *loc. cit.*
[20] McGill, *Public Benefit Foundations Report 2016*, *loc. cit.*
[21] *Ibid.*
[22] European Foundation Centre, *Comparative highlights of foundation laws*, *loc. cit.*

EIP was registered as a public-benefit foundation in Belgium and it can be defined as an operating foundation with public sources of funding. However, it has in its statutes that it can also do grant-making and receive funding from other sources.

2.2. Trends on the development of Foundations in Europe

Foundations, in general, are not static organisations, they change over time and adapt to the changes in their environment. Their mission and programs suffer transformations and are extended as the social context in which they operate evolves.

This section of the thesis aims at highlighting some of the trends on the development of foundations in Europe, namely in terms of support and challenges for their development, how different types of foundations are sourcing their income, how their operations are evolving and what are their trends in terms of investments. This exercise will provide a better understanding of the context in which foundations in Europe operate, and in particular EIP.

Regarding the development of foundations in Europe, two main trends were identified that support and condition its development, specifically the supporting mechanisms and recognition from the EU and its member states and the lack of professional governance respectively.

The EU and its member states have been encouraging the creation and development of foundations via court decisions, regulations and policy guidelines as the *EUROFI Study on European Foundations for Research and Innovation* shows.[23] According to this study, foundations have been considered as good options in securing and complementing public policy goals thanks to their resources.

Another example of recognition by member states in Europe of the importance of European Foundations and their role complementing public policy is reflected through tax reliefs in all European countries (Sweden being the last country to introduce such a mechanism in 2012), as per a 2015 report from the Observatoire de la Fondation de France.[24]

A trend that is limiting the development of foundations in Europe is the fact that they are often run by a voluntary board and lack professional governance. Therefore, they are rarely prepared for professional fundraising, management, communication, and marketing activities. As an example, in Portugal, the national foundations centre, Centro Português de Fundações (CPF), aware of this issue, created in 2013 a Competence Centre for the Foundation Sector as part of its commitment to the professionalisation of management in the sector.

There are different trends on how foundations source their income, depending on their size and operating model. For example, foundations that own small or no endowment funds are financially dependent on EU structural funds or government subsidies.[25] The same EUROFI study made in

[23] Gouwenberg, B., Karamat Ali, D., Hoolwerf, L., Bekkers, R., Schuyt, T. and Smit, J. (2015). *EUROFI Study: European Foundations for Research and Innovation*. Luxembourg, Publications Office of the European Union.

[24] Centre d'Etude et de Recherche sur la Philanthropie (CERPhi), L'Observatoire de la Fondation de France (2015). *An overview of philanthropy in Europe*. http://efc.issuelab.org/resource/an-overview-of-philanthropy-in-europe.html, accessed 10.03.2017

[25] Gouwenberg, *loc. cit.*

Portugal, for example, shows that 27% of foundations in the country are dependent on funding from various government levels (EU, national, regional, local) as one of their main sources of income.[26]

The DAFNE *2016 report* suggests, regarding public benefit foundations, that nowadays many do not have an endowment and instead are engaging in fundraising processes to support their activities, as it is in the case of EIP.[27] In some countries such as Spain and the Netherlands, these fund-raising foundations have even become the majority.[28]

Regarding the evolution of how foundations are operating, three trends can be seen to be emerging: the creation of nationwide group works or associations; collaboration with academia; and playing distinct roles as catalyst, facilitators or convenors.

A rather recent trend of the sector is the creation of nationwide working groups or associations. DAFNE, for example, already has 25 national associations of foundations as members. The European Foundation Centre (EFC) is another example of this trend. EFC is a member organisation of large foundations and already has more than 200 members. In 2014 Belgium created a national network of foundations, La Fédération Belge des Fondations Philanthropiques. This association has more than 80 active foundations in Belgium, including public-benefit foundations, private foundations and foreign foundations. This Belgian network was created, as many other foundations' associations in other countries were, with the goal of promoting the transparency, exchange of knowledge and best practices in the sector while augmenting the visibility of the work done by foundations in the country.[29] This creates the advantage of representing foundations through a unique interlocutor, and enables a homogenous line in the defence of interests of the sector vis-à-vis the government and public institutions, ultimately to influence the conditions that promote the sector's prosperity. The report *Investing Foundations Endowments* shows that these National associations are becoming "key centers of gravity for developing resources and spreading understanding".[30]

The same DAFNE study results support a second trend regarding how European Foundations are operating, which is the collaboration with academia.[31] 51% of the 897 foundations that participated in the study reported having developed joint research activities in partnership with others, with universities being the most popular institutions to collaborate with.[32] This trend of close collaboration with academia is however more common in the case of operating foundations than in grant-making foundations.[33]

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26 Franco, *loc. cit.*
27 McGill, *Public Benefit Foundations Report 2016*, *loc. cit.*
28 *Ibid*
29 Fédération Belge des Fondations Philanthropiques, https://www.lesfondations.be/fr/page/4-qui-sommes-nous, accessed 14.09.2017
30 Knoepfel, I. (2014). *Overview of mission investing by European foundations -Main approaches and recent developments*. onValues, https://www.foundationfuturegenerations.org/sites/www.foundationfuturegenerations.org/files/2014-03-13_foundation3.0_investing_foundations_endowments_for_societal_change_onvalues_ivoknoepfel.pdf, accessed 03.03.2017
31 McGill, *Public Benefit Foundations Report 2016*, *loc. cit.*
32 *Ibid.*
33 Knoepfel, *loc. cit.*

The third trend, highlighted by the book *Philanthropy in Europe - A rich past, a promising future,* is the diverse roles that foundations are playing nowadays in society.[34] Foundations are playing a catalyst role of promoting change in various spheres, from legal to cultural, by supporting research and innovative solutions to societal problems.[35] Foundations are also playing the role of facilitators or convenors, by providing neutral platforms for debate, dialogue and action. According to the book, foundations are "working closely with civil society organizations, governments, scientific and cultural institutions, and other actors".[36] Moreover, DAFNE states, in their *2015 report of the European Foundations sector* that "public benefit foundations are playing an increasingly critical role throughout Europe".[37]

Finally, it is pertinent for this thesis to share some of the trends of foundations regarding their investments. Coutts 2016 Report on Europe identifies three main trends, namely European foundations' increased interest in venture philanthropy, cross-border giving and engagement with social investment.[38]

The report identifies the growth of the European Venture Philanthropy Association (EVPA), the umbrella body of European venture philanthropy funds, as a sign that foundations have an increased interest in venture philanthropy (VP).[39] In general terms, VP refers to the use of venture capital financing principles in the social sector. Some of its distinguishing methods are organisational support, adapted financing and impact measurement and management.[40]

The same report shows another interesting trend of the investment of foundations in Europe, which is not only an increase in cross-border actives but also financing. The pan-european scope has become a characteristic of many foundations in the European continent reflecting the growing number of European associations, such as the European Foundation Centre (EFC), the Network of European Foundations (NEF) and DAFNE. Moreover, the Transnational Giving Europe initiative that resulted from a partnership between major European foundations, also reflects the interests of foundations in reaching beyond their countries.[41] This initiative has allowed individuals and corporate donors from 17 European countries to benefit from the tax reliefs in their own country when supporting a cross-border public benefit organisation in one of the other 16 countries.

The third trend highlighted by the report, and that is crucial for this thesis, is social investment. Together with VP, social investment embodies the interest of foundations in looking for other uses of their funds, in an investment perspective, rather than simple grant making. The expectation of the social investor is to have financial return along with the social and/or environmental ones. And

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[34] MacDonald, *loc. cit.*
[35] *Ibid.*
[36] *Ibid.*
[37] McGill, LT. (2015). *Public Benefit Foundations Report 2015*. Foundation Center https://dafne-online.eu/wp-content/uploads/2015/10/European-Foundation-Sector-report-2015.pdf, accessed 10.04.2017
[38] Coutts & Co, http://philanthropy.coutts.com/en/reports/2016/Europe/discussion.html, accessed 10.08.2017
[39] *Ibid.*
[40] European Venture Philanthropy Association, https://evpa.eu.com/, accessed 10.03.2017
[41] Coutts & Co, *loc. cit.*

although still small and underdeveloped everywhere in Europe, apart from the UK, the social investment market is increasing.

The increasing recognition from EU and its member States of the potential of foundations to play a critical role solving complex societal challenges and the financial support being provided through EU structural funds or government subsidies is contributing to the development of foundations in Europe.

However, many still lack professional governance and many public benefit foundations do not have an endowment fund. It is my opinion that the lack of an endowment fund is the major threat to the development of foundations. I know from experience, working at EIP, that fundraising is a very time-consuming activity and challenging for organisations with a long-term focus. Moreover, it may divert foundations from their core mission.

In order to overcome some of these challenges and others that will be explored in section 2.4 of this thesis, foundations are collaborating more with each other, through the creation of nationwide group works or associations, and with academia and are going beyond grant-making, looking for alternative ways to engage with and support civil society organisations. Social investment is one of these alternatives and the one that I decided to be the focus of this thesis, because I consider it to have an enormous potential for impact.

The following sections and the ensuing literature review will explore the concept and evolution of the social investment sector and, in particular, how and why foundations in Europe are engaging and contributing to its development.

2.3. Social investment

It is key to this thesis to understand the concept of social investment and how flexible it can be from the social investor perspective in terms of returns expectations and financial instruments used. This analysis will be done with a focus on foundations as social investors.

2.3.1 Definition

Social investment may be defined, in general terms, as an investment that generates social return together with financial returns. Social investments may come in many forms and shapes. They may target only the return of the capital, they may have below-market expected rate of returns on investment but also generate a social benefit or they may have market-rates and measurable social impacts.

Currently, social investment (SI) is treated as a separate asset class in the portfolio of investors, alongside cash, debt, public equity and alternative assets that include private equity, venture capital, real estate and absolute return.[42] Social Impact Investment Taskforce suggests that this practice may be useful in the near term, since having dedicated teams to social investments, with an integrated

[42] Social Impact Investment Taskforce (2014). *Allocation for Impact: Subject Paper of the Asset Allocation Working Group* http://www.socialimpactinvestment.org/reports/Asset%20Allocation%20WG%20paper%20FINAL.pdf, accessed 03.03.2017

skill-set and specific budget to invest, has the potential to catalyse greater allocation.[43] However, the expectations are that impact investment will be considered a strategy that can be applied across all asset classes, such as debt and equity, by factoring social externalities into investment decisions.[44]

In the US, other specific terms are used to describe SI, such as Mission Related Investments (MRIs), Program Related Investments (PRIs) and Total Impact Approach (TIA). In the US, where the concept of MRIs emerged, they are defined as investments of a foundation endowment to generate both positive social impact and a financial return.[45] And in the US specific context, it is distinguished from PRIs, which are a technical term of the Internal Revenue Service in the US, defining investments designed to achieve specific program objectives earning most often a below the market return.[46] TIA refers to the employment of all resources, assets and operations of a foundation to serving its mission.[47]

Social investors also have a wide range of backgrounds and expectations. The 2017 GIIN Annual Impact Investor Survey sheds some light on who these investors are: fund managers; foundations; banks; development finance institutions (DFI); family offices; pension plans; insurance companies; and other hybrid organisations such as non-government organisations (NGO's).[48] Apart from these, social investment is also done by governments, high net worth individuals, corporations or mass retail.

The sample from 2017 GIIN Annual Impact Investor Survey reported that about three-quarters of their impact investing assets are invested directly into companies, projects, or real assets.[49] The indirect investments can be made through a variety of channels, such funds and DFI's or social banks and crowdfunding platforms.[50]

The following graphic, although not exhaustive, is a good illustration of the impact investment eco-system, giving examples of who some of these social investors are, shown as sources of capital, as well as some of the financial instruments used, which will be analysed in more detail in the next section of the thesis.[51]

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[43] *Ibid.*

[44] *Ibid.*

[45] Abate, R., Mason, C., Oldenburg, F., Pret, E., Sobolewska, E. and Weber, J. (2017). EVPA Webinar: Foundations & Social Impact Investing – Going beyond grant-making. EU Webinar Series | Session #9 https://evpa.eu.com/pages/eu-webinar-9-foundations-social-impact-investing-going-beyond-grant-making, accessed 03.09.2017

[46] *Ibid.*

[47] *Ibid.*

[48] Mudaliar, A., Pineiro, A., and Bass, R. (2016). *Impact Investing Trends: Evidence of a Growing Industry*. The Global Impact Investing Network (GIIN), https://thegiin.org/knowledge/publication/impact-investing-trends, accessed 04.03.2017

[49] *Ibid.*

[50] *Ibid.*

[51] Social Impact Investment Taskforce (2014). *Impact Investment: The invisible Heart of Markets - Harnessing the power of entrepreneurship, innovation and capital for public good.* http://www.socialimpactinvestment.org/reports/Impact%20Investment%20Report%20FINAL[3].pdf, accessed 03.03.2017

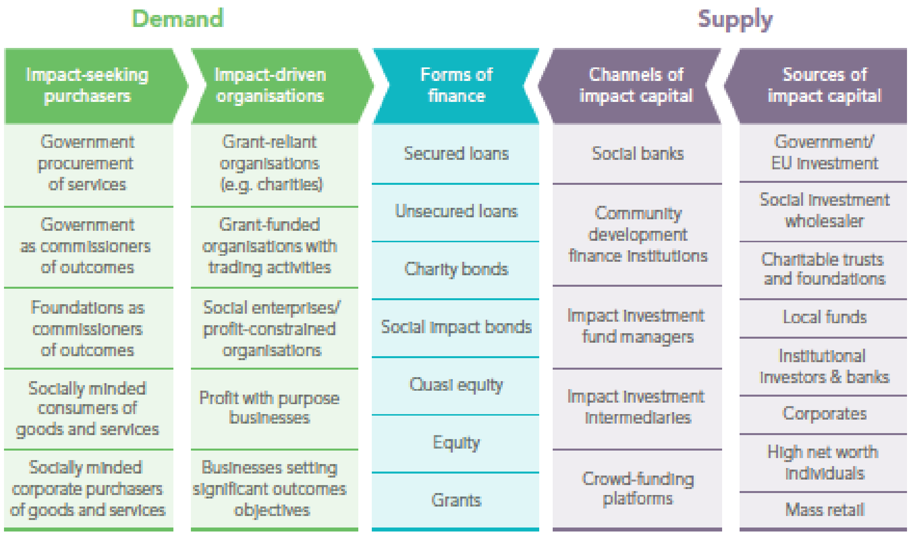

Figure 1. Social Impact Investment Ecosystem (Source: Social Impact Investment Taskforce, 2014)

2.3.2 Financial instruments

Social investments can be made using a variety of financial instruments, including loans, equity, quasi-equity, social impact bonds, social development bonds and grants. This section of the thesis is dedicated to a brief description of each of these instruments, including a view on how they are being used by social investors and some case study examples. The purpose of this section is not to provide an exhaustive list of all the financial instruments that can be used by social investments, but rather to provide a basic understanding of some of the most commonly used.

Loans can be used as a social investment tool either by providing capital at or below market rates or by providing it to people or organisations that otherwise would not have access to it. Different social investors, from foundations to mass retail, are using loans to engage with social investment since it is one of the simplest and less risky financial instruments. Loans can be secured, when an asset is used as collateral, or unsecured. Microcredit is one example of loans being used to create social return and it describes small value loans provided to borrowers that would otherwise not have access to capital since they typically lack collateral, steady employment and a verifiable credit history. It is designed to support entrepreneurship and alleviate poverty. Grameen Bank is a reference in the field, having been the first bank in the world specialized in microcredit. It was launched in 1976 with the goal of eradicating poverty. Loans are available from social banks but may also be available from foundations or individual social investors. Platforms, such as Kiva, connect lenders to low income entrepreneurs and students. Through Kiva, anyone can provide loans, from $25, to individuals or organisations seeking to borrow money. Neither Kiva or the lenders receive any interest.[52] Kiva does, however, receive a commission on amounts raised through the platform.

In the social investment spectrum, there are various small variations of the traditional loans, such as bridging loans, standby/underwriting facilities or overdraft facilities, which have been developed to

[52] Kiva, https://www.kiva.org/about, accessed 04.10.2017

cover short-term cashflow shortfalls and help social organisations survive while other sources of financing are not available.

An equity investment is made when an investor buys share capital. The organisation who sold its shares can then use the funds for start-up, growth or working capital. Because most civil society organisations are constituted as companies limited by guarantee (i.e. with no share capital), they cannot receive this type of investment. Moreover, exit strategies are not always possible as equity offerings in the social sector are typically illiquid. As there is no established market for the shares, it may take a long time before another investor can be found to exchange shares. However, this can be the best source of financing for social enterprises that have a commercial business model that can be scaled-up. Bridges Ventures Fund, for example, invests £2m-£20m equity in businesses pursuing organic growth in four investment themes: Underserved Areas, Environment, Education & Skills and Health & Well-being.[53] The Gym has been one of the flagship investments of the fund equity investments in the Health& Well-being sector. The investment was made in 2008 and the sale of 75% of the shares in 2013 to Phoenix Equity Partners, a private equity investor, represented a 50% IRR and 3.7x multiple for investors in Bridges funds. The Gym pioneered the concept of low-cost gyms in the UK and achieved the social impact objectives of the fund by bringing accessibility and affordability to the health and well-being sector and addressing an important social need amongst traditionally excluded groups due to its location in underserved areas.[54]

Quasi-equity, also known as revenue participation, is a debt-based product which is more flexible than a normal loan and similar to equity regarding the repayment mechanism. Rather than paying back a set amount each month, the repayments are based on the performance of the business – such as profit or turnover. This model can be particularly useful for organisations such as charities, which cannot sell shares or take equity investment or in the cases where a loan would be too risky. In quasi-equity investments, if future expected financial performance is not achieved, a lower or possibly zero financial return is paid to the investor. In reverse, if performance is better than expected, then a higher financial return may be payable. In the UK alone, there are several funds providing this kind of financing. One successful example is the quasi-equity investment made by CAF Venturesome fund in a public interest foundation, Charity Technology Trust (CTT) back in 2007. [55] CTT helps charities become more efficient using information technology and in 2006 began developing a technology donation portal that supplies brand name software at low cost to charities. This development required an investment in infrastructure and marketing of £100,000. CAF started by providing a bridging loan of £50,000, but as CTT was not able to access grant funding, due to their transition to a more commercial business model, CAF decided to invest another £50,000 in the form of quasi-equity. The investment was made over seven years and its repayment would come from a 2 percent share of

[53] Bridges Fund Management, http://www.bridgesfundmanagement.com/the-gym-completes-250m-london-listing-further-proof-that-commercial-growth-and-social-impact-can-go-hand-in-hand/, accessed 25.10.2017

[54] Bridges Fund Management, *loc. cit.*

[55] The National Council for Voluntary Organisations, https://knowhownonprofit.org/funding/social-investment-1/investment-types/quasi-equity-revenue-participation, accessed 26.10.2017

future gross revenues, capped at double the initial investment. After only three years, CTT's revenue exceeded forecast and the charity decided to repay the entire investment to CAF Venturesome. [56]

Social Impact Bonds (SIBs) are investment mechanisms that bring together social investors, social ventures and the public sector. They are translated into contracts made with public sector entities under which the government commits to pay for improved social outcomes. The investment, made by investors outside of the public sphere, is used to pay upfront for a range of activities developed by social ventures with the goal of improving social outcomes. The financial returns are generated by the payments from the government when the previously agreed social outcomes are achieved. In this sense, the investor is the one bearing the risk in case the activities do not deliver the agreed outcomes. This instrument has several disadvantages, such as its comparative complexity and time-consuming set up. The intricate structure of negotiations, coordination and implementation also generate comparatively high administrative costs. However, social impact bonds have the ability to bring together very different actors, in terms of risk profiles and goals, in one single financing tool. The government has social impact goals, just as mission -driven organisations have, but it is not flexible nor efficient enough to solve the problems society faces and has a very risk averse profile. The investor has more of a risk-taking profile and finds in this tool an opportunity to use its funds for a project that creates impact and aligns with its vision. The social venture has an efficient solution and a risk-taking profile but lacks funds to test or scale innovative solutions. Moreover, all these actors are interdependent in the sense that the social developer needs the funds from the investor and the final payment from the government in case of success; the investor needs the social project developer to initiate and manage the project and the government to pay him back in case of success; the government needs the investor to assume risks he is not willing to assume and the social project developer to come up with project that solves in a more efficient way the problems faced by society. One could also argue that this way of investing brings a "business" mentality to social projects, focusing on data, outcomes and measurements, which increases the rigor of these projects. As per the live global database of Social Impact Bonds managed by Social Finance Global Network, as of October 2017, 89 Social Impact Bonds have been launched since 2010, in 19 countries, raising more than $320m. The World's first SIB, Peterborough Social Impact Bond, was launched in 2010 and aimed for a reduction of 7.5% in the number of short-sentenced offenders reoffending after leaving Peterborough prison, and is now a success case study[57]. Social Finance raised £5 million from trusts and foundations to launch this SIB and funded the One Service – an umbrella organisation. One Service was delivered by several organisations, namely St Giles Trust, Ormiston Families, Sova, MIND, TTG Training, YMCA and John Laing Training, and was managed by Social Finance. It was offered to two cohorts of 1000 short-sentenced male prisoners for a period of up to 12 months post-release. In July 2017, the Ministry of Justice announced that the Peterborough Social Impact Bond had reduced reoffending of short-sentenced offenders by 9% overall compared to a national control group. As a result, the 17 investors in the Peterborough SIB will receive a single payment representing

[56] The National Council for Voluntary Organisations, *loc. cit.*

[57] Social Finance, http://www.socialfinance.org.uk/projects/peterborough, accessed 05.11.2017

their initial capital plus an amount that will represent a return of just over 3% per annum for the period of investment.

A Development Impact Bond (DIB) is a variation of the SIB model that provides new sources of financing to achieve improved social outcomes in developing countries. As with SIBs, investors provide external financing and only receive a return if pre-agreed outcomes are achieved. In developing countries, public authorities might not be in a position to pay for improved social/environmental outcomes and would need to rely on external assistance. Therefore, in DIBs the funds to remunerate investors do not have to come from the government, but may come in part or totally from donors. These donors are often development and cooperation organizations, foundations or other philanthropists. Some argue that DIBs have the potential to improve aid's efficiency and cost-effectiveness by shifting the focus onto implementation quality and the delivery of successful results. The first DIB was launched in June 2015 by Instiglio, Children's Investment Fund Foundation (CIFF), Educate Girls, IDinsight and UBS Optimus Foundation.[58] The objective of the DIB was to reduce the gender gap in education in Rural India by getting girls into school and learning. UBS is the investor, providing working capital to an Indian NGO, Educate Girls, to develop its program.[59] The model measures progress against agreed targets for the number of out-of-school girls enrolled into primary education and the progress of girls and boys in English, Hindi and mathematics. After three years, CIFF (the outcome payer) will pay based on enrolment and learning outcomes that IDinsight will evaluate in three RCTs at Years One, Two, and Three. UBS Optimus Foundation stands to receive their initial investment back plus a return on investment based on the performance of the program. Year two results show that Educate Girls has achieved 87.7% of the 3-year enrolment target and 50.3% of the 3-year learning target. Although several DIBs are at an advanced stage of design, only one more has been launched in the meanwhile, for sustainable coffee and cocoa production in Peru.[60]

For clarification purposes, it is worth mentioning that these same financial instruments can be used by Venture Philanthropy (VP). VP is a type of social investment that applies the tactics and concepts of venture capital and business management to achieving philanthropic goals.[61] It seen as a high-engagement approach to social investment and grant-making across a wide range of Social Purpose Organisations (SPOs).

Apart from the funding provided by social investors through these instruments, there are also other funding options available for social ventures, such as accelerators, incubators, competitions or crowdfunding. Accelerators or incubators may provide business ideas that have potential to scale with early-stage investment and other kind of support, like training and office space. Crowdfunding is a way to collect small donations (or loans or equity) from many people who support what the organisation or

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58 Center for Global Development, https://www.cgdev.org/blog/first-development-impact-bond-launched, accessed 19.09.17

59 *Ibid.*

60 United Nations Development Programme, http://www.undp.org/content/sdfinance/en/home/solutions/social-development-impact-bonds.html accessed 19.09.17

61 Clark H. and Weiss, T. (2006). 'Venture philanthropy' is new buzz in business: Buffett, Gates not the only tycoons reshaping world of charitable giving. Forbes. http://www.nbcnews.com/id/13556127/#.Wf81q2i0PIU, accessed 05.11.2017

the person is doing, instead of trying to collect funds from just one or from a limited number of social investors.

2.3.3 Development of Social investment

This section is the result of a review of available literature on the development of social investment, including what social investors believe is driving it, how foundations are influencing it and what are the main challenges and opportunities it faces.

The Global Impact Investing Network (GIIN) published in December 2016 a report on the Impact Investing Trends, based on the annual surveys conducted to impact investors between 2013 and 2015 and interviews.[62] During the interviews, several impact investors mentioned factors that they believe are contributing to the development of social impact.

The first factor is the continuing improvement of impact measurement and management practices. Impact investors are developing models that capture better both direct and indirect outcomes of the investments and expectantly will increase the quality of the data being reported.[63]

The second factor is the growing potential that social investment has to play a catalytic role in unlocking other finance and making new deals possible. Impact investing has the potential to increase the private capital dedicated to solving social and environmental challenges. This happens, for example, when impact investors assume a second loss position and consequently decrease the risk of the traditional investor and when they facilitate public-private partnerships, through SIB/DIB models.

The third factor is the existence of an intermediary market that is increasingly specialized, with the creation of more funds focused on specific geographies and themes and a structure that accommodates both private and public capital. The fourth and fifth factors are the increasing variety of financial instruments being used by social investors and the expectation that accelerator programs will pay an important part in developing quality investing opportunities

In their article, *Philanthropic Pioneers: Foundations and the Rise of Impact Investing,* Mission Investors Exchange shares how foundations are influencing the development of the impact investing field.[64]

One of the ways foundations are influencing the development of social impact is by promoting the rise of new kinds of investment.[65] Foundations are considering a wider range of risk, return and impact options when looking at their investment portfolio. They are more flexible to modify their financial risk-return balance in order to achieve the impact that makes sense for them. Omidyar Network is an example of this practice. In addition to having a sliding scale of impact and financial returns, Omidyar

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[62] Mudaliar*, Impact Investing Trends*, *loc. cit.*
[63] *Ibid.*
[64] Onek, M. (2017). *Philanthropic Pioneers: Foundations and the Rise of Impact Investing*. Stanford Social Innovation Review, https://ssir.org/articles/entry/philanthropic_pioneers_foundations_and_the_rise_of_impact_investing, accessed 01.03.2017
[65] *Ibid.*

Network goes even further by remaining flexible and open to modifying their risk-return profile during the life of an individual investment.

In addition, foundations are influencing the development of social investment by being more willing to collaborate with investors in the private and government sector and by assuming more risk so that more capital is available for impact.[66] The article relates this behaviour to the fact that foundations understand that more capital needs to be deployed for impact and are aware that they cannot achieve it alone.[67]

Furthermore, foundations are playing an important role by leveraging the financial capital provided by traditional investors, with their human, social, intellectual and political capital.[68] Being aware that financial capital is not enough to achieve impact in the complex social challenges, foundations are supporting social ventures in complementary ways.

As a last point, foundations are also contributing to the progress of social investment by sharing information about their experiences and bringing together different actors to disseminate best practices.[69] This is of particular relevance when the stage of development of social investment starts raising questions about its structure, terms, measures and achievements.

In the Webinar *Foundations & Social Impact Investing - Going beyond grant-making*, hosted by EVPA on March 2017, European foundations that are doing social investment shared their opinion about what they believe to be the challenges and opportunities of the social investment sector.[70]

Felix Oldenburg, Secretary General of Bundesverband, the association of German foundations, believes that the fact that investors still look at investees from the impact or from the finance lens is a challenge that social investment needs to overcome.[71] So far foundations and other actors, such as banks, private investors or donors, look at organisations or business ideas in silos, in the sense that they can either only be developed with grants or be commercially financed. Felix states that this is, however, not the case for most investees, which could benefit from both types of support. In this complex context, foundations should approach them in a flexible way, both as grant makers and investors. so that the form of financing follows the impact. Caroline Mason, Chief Executive of Esmée Fairbain Foundation, one of the largest independent grant-makers in the UK, reinforced the message, advocating the need for a single approach of social investment and grant making, putting the right combination of financial instruments together at the foundation's disposal to optimise the help provided to organisations.[72] Caroline disclosed that her foundation has been working towards this single approach by merging both teams of social investment and grant making.[73]

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66 Onek, *loc. cit.*
67 *Ibid.*
68 *Ibid.*
69 *Ibid.*
70 Abate, *loc. cit.*
71 *Ibid.*
72 *Ibid.*
73 *Ibid.*

Additionally, Felix Oldenburg argued that in the future different actors will have to work closely together to develop hybrid forms of financing instruments that can be adapted to the different development stages of the organisation or the specific sector in which it operates.[74] He goes a bit further, stating that the growth of the social impact market depends on foundations working better together, and with other investors, creating these combined forms of financing.[75]

Caroline Mason also acknowledged the blurring of boundaries between philanthropy, social investment, and mainstream investment and identified three opportunities that may promote the growth of social investment in the UK.[76]

The first one, is the opportunity that is being created by Brexit for organisations to engage in new conversations with the government and present innovative ideas to solve societal problems, namely social enterprise models or corporative models that address public services delivery.

The second opportunity for the growth of social investment is related to the trading models of different sectors, such as food, community transport, arts, environment or insurance, which could be explored as a field of social investment for the traditional private capital. In the insurance sector, for example, companies can pay for good outcomes, financing the restoration of wetland and peaks that will reduce the risk of flooding and thus reduce the risk of insurers to pay indemnities.

The final growth opportunity recognised was in the retail investment sector. Caroline believes this sector can be further explored by getting ordinary people to invest in saving products, pension funds or bond products.

In Italy, five sectors have been identified as the ones with highest potential for impact investment: healthcare, disability, social inclusion, family and housing. [77]

In the same Webinar, Johannes Weber, Project Manager at the BMW Foundation, highlighted that social investment funds are an attractive solution for foundations that want to engage with social investment but that are either risk averse or have limitations on their direct investments.[78] Foundations may have, due to the country regulation where they operate, limitations on the amount and type of direct investments they can do.[79] Investing in funds may be a solution to overcome this limitation since they are not direct investment. Furthermore, due to their nature, funds provide an “immediate” portfolio diversification that has a reduced risk when compared to single or limited number of investments. Ron Cordes also identifies impact investing through donor-advised funds as a promising opportunity because they can be used by foundations as a “straightforward way to embrace impact investments within a contained and well-understood financial vehicle” .[80] Moreover, as the co-founder of Corder

[74] Abate, *loc. cit.*
[75] *Ibid.*
[76] *Ibid.*
[77] *Ibid.*
[78] *Ibid.*
[79] *Ibid.*
[80] Cordes, R. (2014). How Foundations Invest Money Is Just As Important As How They Make Grants. Cordes Foundation, http://cordesfoundation.org/2014/09/21/how-foundations-invest-money-is-just-as-important-as-how-they-make-grants/, accessed 03.03.2017

foundation, he sees these funds as a “great choice (…) for foundations to take their first steps in the field of impact investing” .[81] This last opportunity is particularly pertinent for this thesis and it will be further explored in detail as applicable to the case of EIP.

All the analysis above is relevant to the case discussion of EIP since it provides an overview of the development trends of the social investment sector, including challenges and opportunities and may inspire how EIP as a foundation can leverage the growth of social investment to better achieve its mission.

A trend strongly affecting the social investment sector, and rmentioned in various sources, is the fact that the 17 Sustainable Development Goals (SDGs) adopted by countries on September 25th, 2015 are evolving as a reference/guide for those who seek to make investments that create impact. The strong sense of urgency for addressing social, economic and environmental challenges prompts investors with diverse profiles to consider how their capital can be leveraged to achieve long-term solutions. This trend will also be taken into consideration in the discussion of EIP case.

The section 2.2 of this thesis outlined social investment as one of the trends of foundations' investments. This section introduced the social investment's concept and ecosystem, the distinct financial instruments being used by social investors and the trends, opportunities and challenges of its development, including how foundations can influence it. The following section of the thesis will focus on exploring the reasons behind foundations engagement with social investment.

2.4. Why Foundations are engaging with social investment

The operational model of grant-making foundations has traditionally been one of investing their endowment funds, also referred to as capital, in profit making financial investment in order to get a financial return from these investments. This financial return is then used to award grants to non-profit organizations that develop projects aligned with their mission. The majority of foundations for Research and Innovation in Europe, for example, derive their income from an endowment (63%).[82]

The fact is that foundations are becoming more creative in the use of the return from their endowment, and in some cases even in the use of investments made with the endowment, engaging with social investment as an alternative to grant-making or to investing in business with the solely goal of a financial return.

There are multiple lines of reasoning that justify this trend and each foundation can have distinct motivations for engaging with social investment. Therefore. this thesis does not intend to evaluate the different rationales, but instead articulate the justifications for the use of social investment by foundations.

Some authors argue that the interest of foundations in social investment is a reaction to the lower portfolio returns since the financial crisis, which triggered the largest impact investment growth of all

[81] Cordes, *loc. cit.*
[82] Gouwenberg, *loc. cit.*

time.[83] With the reduction of their "budget" for grant-making, foundations may have felt the need to use all their resources in order to accomplish their mission. With regards to the use of the endowment fund in social investments, the report *Investing Foundations Endowments* mentions that more than ever foundations need to use all their resources in a creative way (including the capital) to achieve their mission ".[84]

Other authors claim that the engagement with social investment is the result of foundations' stakeholders becoming more demanding with the results they expect foundations to achieve and with the ways they are achieving it. Because foundations' stakeholders are more demanding with the transparency on the investments made by foundations' endowments, they are more aware of the misalignment that sometimes exists between the investments that were generating the financial returns and the foundations' mission. In this context, social investment becomes an alternative source of financial return, with the advantage of also generating impact aligned with the foundation's mission. It was already mentioned in the Esmée Fairbairn Foundation report from 2015 *Foundations and Social Investment* that "foundations face an increased pressure to demonstrate that their practices, including their investment approach, reinforce rather than undermine their mission". [85] A visible case in point was the scandal involving Bill and Melinda Gates foundation that was investing part of its endowment funds in fossil fuel companies while claiming that stopping environmental change was one of their priorities on the grants concession front.

I do not consider, however, that the financial reasons mentioned above are the ones that justify foundation's engagement with social investment. My argument is that social investments are not seen by foundation as substitute investments in terms of financial return. There is still limited evidence of social investments' financial performance and data shows that when foundations engage with social investment, most target below-market rates of return.[86]

A third potential justification, advanced by The New York Times article *To Advance Their Cause, Foundations Buy Stocks*, is the fact that foundations are ever more uncertain about how they can achieve their goals.[87] This may justify why foundations are more willing to engage with profit making business and social ventures, besides non-profit, as long as they believe it is the best way to achieve their goals. Some foundations even run for-profit business, in line with their mission. Fundação Eugénio de Almeida, whose mission is to aid the development of the Évora region, by encouraging cultural, educational, social work and spiritual initiatives is one Portuguese example of a foundation

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83 Bugg-Levine, A. and Emerson J. (2011). Impact Investing: Transforming How We Make Money while Making a Difference. *Innovations: Technology, Governance, Globalization* Summer 2011, (Vol. 6, No. 3, pp 9-18)

84 Knoepfel, l*oc. cit.*

85 Bolton, M. (2015). *Foundations and social investment: making money work harder in order to achieve more*. Esmée Fairbairn Foundation, http://esmeefairbairn.org.uk/news-and-learning/publications/foundations-and-social-investment, accessed 05.03.2017

86 Mudaliar, A., Schiff H., Bass R. and Dithrich, H. (2017). *2017 Annual Impact Investor Survey*. Global Impact Investing Network (GIIN). https://thegiin.org/assets/GIIN_AnnualImpactInvestorSurvey_2017_Web_Final.pdf, accessed 05.11.2017, p. 3

87 Strom, S. (2011). To Advance Their Cause, Foundations Buy Stocks. New York Times. http://www.nytimes.com/2011/11/25/business/foundations-come-to-the-aid-of-companies.html, accessed 03.03.2017

that runs a for-profit business.[88] The foundation runs a renowned regional winery that is aligned with their mission of Évora's regional development.

A fourth motivation for foundations to engage with social investment is that it is a form of investment that requires more interaction between the investor and the investee also due to the non-financial support that is often provided. Foundations state that, by incorporating investment strategies into their work with partners, both non-profit and for-profit enterprises, they build stronger working relationships and impact. This reasoning is further developed in one of the key findings of the CEP report *The future of foundation philanthropy*. [89] The report states that most foundations' CEOs believe their foundations have the opportunity, due to their unique role, to experiment and innovate and that they see collaborating with those they pursue to help as a way to create greater impact. From the perspective of foundations doing fundraising, they see receiving funds from social investment as a way to engage more with existing and potential donors, when compared to receiving funds from grants.

A fifth motivation for foundations to be investing their capital in profitable public-benefit organizations that they believe are aligned with their missions is the desire to attract the traditional financial investors to this type of mission-oriented business. One example of this incentive is the statement of David & Lucile Packard Foundation's general counsel about the foundation's investment in Ecotrust Forest Management "Our main reason for investing in Ecotrust Forest in this way is to demonstrate that sustainable forest practices can generate a profit so that mainstream investors will become more interested in it."[90]

Furthermore, some foundations are engaging with social investment because they realize that the size and complexity of the problems demand capital far exceeding the supply of it and grant-making alone cannot fill that gap.[91] In such setting, they are becoming more flexible with their grantees on the strategies that they use to achieve their mission, including social investment.

My opinion is that the three reasons above justify most of foundations' interest in social investment. Foundations are mission-focus organisations and, aware of the size and complexity of the societal problems, are willing to try different approaches. So, even though they are experimenting with social investment, their engagement with this type of investment is still marginal. I believe most foundations consider the biggest promise of social investment to be its potential to attract more capital for mission-oriented business, including the capital from traditional financial investors.

Finally, some authors argue that this engagement is justified by the fact that there is a growing supply of social entrepreneurship projects available for investment, from "a new generation of business and socially savvy entrepreneurs".[92] The report *The invisible heart of markets*, for example, refers as

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[88] Fundação Eugénio de Almeida, http://www.fundacaoeugeniodealmeida.pt/, accessed 16.09.2017

[89] Buteau, E., Orensten N., and Loh C. (2016). *The Future of Foundation Philanthropy: The CEO Perspective*. The Center for Effective Philanthropy, http://research.effectivephilanthropy.org/the-future-of-foundation-philanthropy, accessed 05.03.2017

[90] Strom, *loc. cit.*

[91] Berliner, P. and Spruill, V. (2013). *Community Foundation Guide to Impact Investing: Reflections from the field and resources to move forward*. Mission Investors Exchange, https://www.missioninvestors.org/system/files/tools/FieldGuide_102113_PRINT_v3.pdf, accessed 01.03.2017

[92] Bugg-Levine, *loc. cit.*

remarkable "the number of entrepreneurial start-ups emerging that have social mission at the heart of their organisation and the variety of business models they use".[93] Johannes Weber, during the EVPA webinar, also mentions that socially-driven innovative start-ups in Italy are showing an attractive growth trend.[94]

The motivations listed above are the result of a detailed review of literature on foundations that have engaged with social investment and have shared their drives to do so. The result is a diverse mix of justifications, from the reasoning that foundations have less financial resources available, to the argument that the problems foundations try to solve are more complex and demand both that foundations are creative in how they use their resources and in addition try to mobilize additional capital, from different profiles of investors. There may be other drives that were not discussed in this thesis, however the motivations that were discussed made it possible to conclude that foundations have distinct levels of commitment towards social investment. While some foundations seem to believe it is part of the solution to fill the gap between the demand for capital for increasing complex problems and the limited funds available, others see it as part of their role as innovators.

The next section of this thesis will elaborate more on this commitment, analysing how and to what extent foundations are doing social investments.

2.5. Why Foundations are in a strong position to support and engage with social investment

2.5.1 Arguments

Foundations are in a unique position to take the lead in social investing. They have far more experience than any other player since they have engaged in "social investing" for centuries, even before the term being invented, and they have already a deep commitment to it[95]. Moreover, they can provide more patient capital than other investors, being more flexible and risk tolerant at the same time. Foundations are taking advantage of their capital profile to fund seed social investments. By de-risking some markets, they expect to attract other types of investors, including the private sector and government, exponentially increasing the capital available to accelerate impact investing.

The argument of patient capital is also mentioned by Rafaella Abate, the Financial Officer of Fondazione Cariplo, [96] and, although the plan of the foundation to engage with social investment is still being finalised, one of the goals of the foundation is to use its endowment to supply patient capital to socially-driven organisations with limited expected financial returns. Moreover, Rafaella Abate argues that the non-profit nature of the foundation is coherent with the principle of sharing the skills that the team will develop in the process. This sharing of skills and knowledge may happen between the foundation and its investees, as well as among social investors

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93 Social Impact Investment Taskforce, *Impact Investment, loc. cit.*
94 Abate, *loc. cit.*
95 Hopt, *Annex H- Types of Foundations, loc. cit.*
96 Abate, *loc. cit.*

Due to their focus on mission, foundations like Fondazione Cariplo are interested in broadening the impact investing ecosystem and working together to understand what is working and why at the impact level. By sharing their knowledge and allowing others to learn from their failures and successes, they play a key role in developing the social investment sector. Ron Cordes also mentions the opportunity that foundations have to serve, not only as impact investors, but also as "leaders in developing the structures and processes required to support investment in social enterprises". [97]

Another argument often found in the literature of foundations is that due to their nature, being close to the community and experience solving social problems, foundations are in a better position to monitor and evaluate social returns, as well as to hold investees accountable. Foundations can fill in the gap that currently exists in capital markets serving social or environmental good, by providing credible information on high quality local partners and investment opportunities. This can be made concrete when foundations co-invest with national and regional investors. Foundations have the potential to position themselves as a "go-to" knowledge hub by providing information for potential investors.

Moreover, foundations have historically been focused on developing/unleashing their social capital, since their own survival and development depended on it. Nowadays, they not only have the experience, but they are also aware of how important it is to be close to the problems and being able to influence those who can help solve them. "They are naturally positioned to raise awareness of and provide credible information about the emerging field".[98]

On the other hand, their positioning of proximity with the non-profit sector also makes them essential in the task of making "the right" non-profit organizations aware of impact investment opportunities and how they can benefit from and engage with this type of investment.

Additionally, the Chief Executive of Esmée Foundation remarks that there is a need for organisations to start using social investment as a financial source and that foundations can provide the support for organizations to transit into more sustainable models.[99] By being able to act both as grant makers and investors, foundations can adapt their financing to the development stage of the organisation and help them make the transition from a business model that can only be supported by grant to one that provides some financial return as well and, therefore, attracts other investors.

2.5.2 How and how much are foundations engaging

European foundations are going beyond grant making and they are engaging with social investment in a variety of ways. Some are making direct investments in other charities or in social enterprises, providing loans or buying equity. Others are engaging through SIBs or DIB as investors, as developers or as donors responsible for the payback in case of success. Some foundations are developing challenges and providing prizes to the most innovative social ventures. Some foundations are supporting, through grants or loans, the creation of hubs and incubators dedicated to helping social ventures strive. BMW Foundation, for example, engages in two ways, through direct investments in

[97] Cordes, *loc. cit.*
[98] Berliner, *loc. cit.*
[99] Abate, *loc. cit.*

selected impact investment funds and direct investments through an impact investment program, and through the promotion of the topic by supporting convenings, knowledge building, building of bridges between actors, and support of intermediaries. One example is its support to the Impact Hub, a global movement of almost one hundred social enterprise co-working ecosystems at the city-level, in operation or development.[100]

Charity bonds are another way used by charities to engage with social investors, including individuals, other foundations and institutions. A Charity Bond is a tradable loan between a charity or social enterprise and a group of social investors. Charities and social enterprises can then invest these funds in activities that will generate additional social impact and support their scale and long-term sustainability, as well as repaying the original investors. The charities issuing the bond also commit to report on the social impact created through their work to investors. Therefore, they are sometimes used by charities to raise public awareness of the charity's work and engage new supporters from different socio-economic groups. It typically offers investors a fixed rate of interest and has a fixed period.

In addition, some foundations are investing in social investment funds or creating their own funds in specific fields aligned with their mission. Nesta foundation, for example, created an Arts Impact Fund, which provides repayable finance between £150,000 and £600,000 to arts organisations in England with ambitions to grow, achieve great artistic quality and have a positive impact on society. [101] Nesta's social investment fund is aligned with the foundation's mission of supporting innovative ideas and working in partnership with others to tackle the big societal challenges. Moreover, the creation of the social investment fund is a form of engaging with social investment that allows tackling, in a preventive and sustainable way, the core mission of the foundation. This thesis will look at EIP and its domain of work, namely peacebuilding and conflict prevention, and explore how a social investment fund could help the foundation achieve its mission in a preventive and sustainable way.

Despite the many examples available, numbers on impact investing done by Foundations in Europe are not easy to find. According to Johannes Weber, Program Manager at BMW Foundation, this information is "hard to collect because foundations, in general, don't want to talk about how they invest their endowments".[102] Furthermore, this fact is also explained by the many different contexts across the European Union, especially regarding fiscal, legal, and social frameworks, which make it very difficult to have accurate statistical estimates on public-benefit foundations across Europe. Knowledge on the foundation sector is thus more concentrated at national level by national associations of donors.

As a national example, one Italian foundation reported that, in Italy, in 2015, close to 936 Million Euro were being used by foundations to fund social projects.[103] At the end of 2015, they held approximately

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[100] BMW Foundation, http://bmw-foundation.org/, accessed 23.09.17

[101] Nesta, https://www.nesta.org.uk/about-us/our-history, accessed 07.06.2017

[102] Abate, *loc. cit.*

[103] *Ibid.*

€ 41 billion in total assets. These figures translate to a 2% allocation of foundations assets in social investment.

Additional numbers regarding social investment were shared by Esmée Fairban Foundation, who owns an endowment fund of £1bn as at December 2016.[104] The foundation reports investing £5m a year in social investment projects, with a total of £45m allocated so far. These investments are being done in diverse sectors, including arts, children and young people, environment, food and social changes, and using a wide range of financial instruments. At December 2016, the foundation reported 116 social investment in their portfolio, 47% through debt, 15% through funds, another 15% through land purchase and the remaining using equity, quasi-equity, social impact bonds and others not identified. The foundation's social investments have an average term of 6 years and, so far, a net return of 2%. However, the Chief Executive shares that the main target of their social investments is to create a social return equivalent to the one generated by grants. As for the financial return, the aim is to recover, at a portfolio level, 100% of the initial capital with a 0% return net of costs.

The 2017 GIIN Annual Impact Investor Survey provides data on a worldwide perspective about how much foundations have invested and how much capital they plan to allocate to social investment in 2017.[105] From the 113 foundations participating in the study, only 1% are not interested in impact investment, and 48% are already allocating capital to impact investment. The survey also shows that most foundations (61%) target below-market return rates. A total of 23 foundations informed to have invested, during 2016, USD 550 million in 112 impact investments. At the median, foundations invested USD 11 million in 5 impact investments, during 2016. This set of foundations plans to invest USD 730 million into 133 impact investments during 2017, indicating growth of 32% in the amount of capital invested and 18% in terms of number of investments compared to 2016. These 23 foundations reported to have a total of USD 3,982 billion impact investment assets. Most fund managers (61%) reported to have raised capital from foundations, which reflects a high engagement from foundations with this impact investment intermediaries.

Despite these numbers, it is important to note that impact investing is still a niche market in most developed countries and that there is still limited evidence of its financial performance. And despite its encouraging growth trends, is far from comparable to other asset classes. To support this argument, during EVPA Webinar, the Secretary General of Bundesverband, the Association of German Foundations, referred to the impact investment market in Germany as being tiny, representing only a couple of million euros.[106] He also underlined the importance of not overstating the immediate market potential. According to him, the difficulty of social investment funds is not to collect money, but instead to "allocate money to social enterprises that have an impact promise".

The future and the impact of social investing is still uncertain, and the materialization of its potential depends on "new laws, new systems for measuring value, new capital market innovators, new

104 Abate, *loc. cit.*
105 Mudaliar, *2017 Annual Impact Investor Survey*, *loc. cit.*
106 Abate, *loc. cit.*

approaches to cultivating leadership—these will be the drivers that convert this current into a powerful force". [107] Foundations have the potential to play a central part in its development.

3 EIP & Conflict Prevention

3.1. EIP Background

The European Institute of Peace (EIP) was as result of an initiative launched by the Foreign Ministers of Sweden and Finland to augment the global peace agenda of Europe through an external tool. Three main studies were commissioned by the European parliament on the establishment of an EIP, including a study on a blue print for the Institute, a cost-benefit analysis, and a study on the added value and financial appraisal. The last one included the evaluation of the best legal form for the organization, considering that, in order to guarantee its flexibility and freedom, it would have to be an organization independent from the EU. It was followed by a financial appraisal note, requested by the Committee for Foreign Affairs (AFET), on the possible costs of establishing a European Institute for Peace under the legal forms of an association, a foundation or an international organization[108]. The conclusion was that the best legal form was a foundation due to the fact that it does not oblige its members to a fixed fee and has more extensive funding options, including private donations. Another argument used was that a foundation has a less complex governance system, and the executive could thus be more decisive and that might make a difference in smoothness of operation. The foundation was then launched in May 2014 having Belgium, Finland, Hungary, Italy, Luxembourg, Poland, Spain, Sweden and Switzerland as founding members.

Presently, EIP operates in three main areas: Mediation and Dialogue; Understanding Extremism; and Quality of Mediation. In the Mediation and Dialogue area, it develops projects in regions such as Syria, Yemen, Libya, Iraq and South-Eastern Europe. These projects are highly sensitive in terms of confidentiality and generate no revenue. Because of this, grants are the best tool to fund them. Grants require no financial return on investment and can be quite flexible in terms of reporting and monitoring.

The Understanding Extremism area is focused on producing studies that can be used to reduce polarisation and mitigate the risk of extremism in European societies. So far, EIP has not been able to secure any funding for this area and hence only developed a limited number of projects that were covered by its core budget. One of the studies performed by EIP on this area was one comprehensive study of the two Molenbeek districts, entitled *Molenbeek and violent radicalisation: 'a social mapping'*.[109] Although being funded by EIP core budget, this study has called the attention of several governmental and non-governmental organisations working in the theme of extremism and it was even considered a useful tool by the local police.

[107] Bugg-Levine, *loc. cit.*

[108] Poot, H., Vogt, A., and Van der Sleen, M. (2013). *European Institute of Peace: Costs, Benefits and Options - Financial appraisal*. European Added Value. http://www.europarl.europa.eu/RegData/etudes/etudes/join/2013/504465/IPOL-JOIN_ET(2013)504465_EN.pdf, accessed 05.11.2017

[109] European Institute of Peace (2017). *Molenbeek and violent radicalisation: 'a social mapping'*. https://view.publitas.com/eip/eip-molenbeek-report-16-06/page/1, accessed 05.11.2017

The Quality of Mediation area aims to improve the quality of mediation and its support structures through innovative and pragmatic thinking. This area mainly develops studies, supported by grants. It was only in 2017 that EIP began applying for tenders and creating workshops that generate revenue.

Although the EIP has in its statutes the possibility of working as grant-maker, up until now it has been a 100% operating foundation. The EIP is funded by membership contributions that cover its core expenses and develops projects that are funded by grants. Currently, both the members and grant donors are mainly Ministries of Foreign Affairs (MFAs) from European countries. Apart from grants coming from the MFAs' budgets, EIP received in 2017 its first three grants from the European Union. It is worth clarifying that not all members provide grants for projects and not all grant donors are members. Moreover, because membership contributions are negotiated on a yearly basis and grants are negotiated on a project basis, the long-term sustainability of the foundation is fragile. Its initial reserve was small, and it has been decreasing due to overspends on projects and projects' scoping missions that are not funded by dedicated grants.

The EIP spends part of its core budget to scoping missions that identify possible areas of conflict where EU has limited freedom or ability to act and EIP can make a difference through mediation and dialogue. It is only after this scoping phase that EIP is in a position to develop specific project proposals and to promote them on the outlook for obtaining funding. Due to EIP's current funding structure, it is possible that projects are identified by EIP as being very important but are not actually implemented due to lack of funding.

So far, due to the nature of the projects being developed, the funding of all the projects has been done through grants.

It is part of EIP's financial strategy to strengthen its sustainability and ability to develop more projects. In this context, EIP is on the lookout both for different sources of funding and for different ways to achieve its mission. These sources must, however, be adequate to the type of activity being developed by the foundation.

Albeit several options are available to support the funding and development of EIP in achieving its mission through the development of its own projects, this thesis does not focus on these potential sources of funding. Instead, this thesis' focus is the analysis of the opportunity that social investment may represent for EIP to grow and explore other ways to achieve its mission.

As studied in the previous sections of this thesis, there are many ways in which foundations may engage with social investment. However, most of them require funds to do investments. Since EIP is currently a 100% operating foundation and does not have an endowment fund, it would have to create a fund that could be dedicated to this type of investment. This thesis will therefore explore the creation of a social investment fund by EIP. The next question this thesis answers is what would then be the focus of EIP's social investment fund and how it could be best aligned with the foundation's mission and current work.

To answer this question, it is useful to gather a better understanding of the fields of peacebuilding and conflict prevention, in which EIP's projects are developed. The next section is thus dedicated to the analysis of conflict evolution and the discussion on possible gaps and/ or opportunities where this fund could be deployed.

3.2. The Curve of Conflict

The curve of conflict is the tool used in this thesis to analyse the evolution of conflict and the differences between its prevention and resolution. The curve of conflict was introduced by Michael Lund, a political scientist with over 30 years of experience and a renowned specialist in conflict prevention and post-conflict reconstruction.[110] The Curve of Conflict, also known as Lund's curve, is a reference in how the dynamic of the conflict changes over time and it is used by The United States Institute of Peace (USIP). USIP is the American version and the inspiration for the creation of EIP.

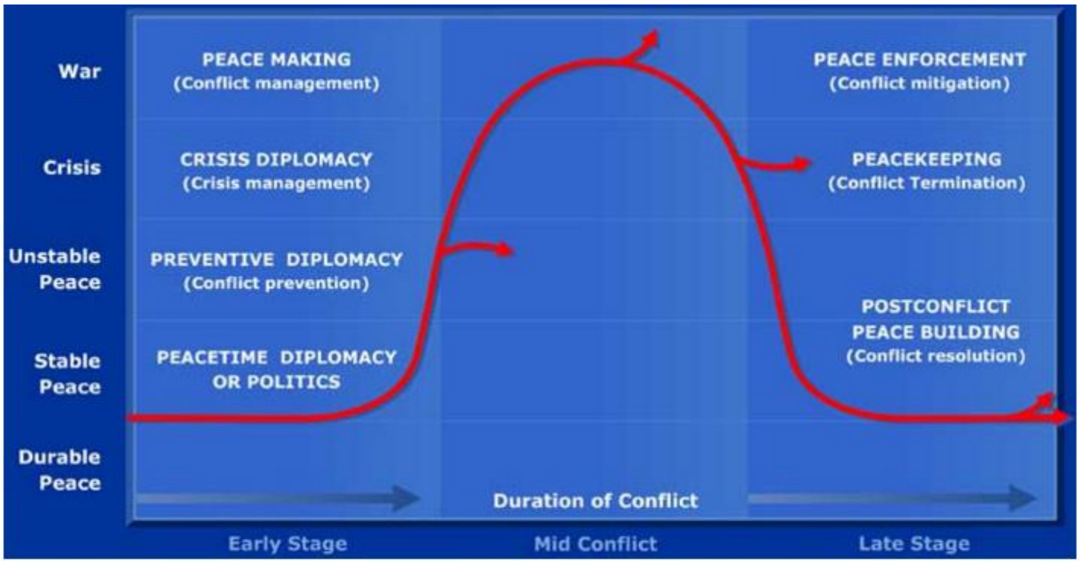

Figure 2. The Curve of Conflict (Source: United States Institute of Peace, 2004)

The curve is a visualisation tool that facilitates the understanding of the typical evolution of conflict, illustrating the depth of peace or intensity of violence over time. The horizontal axis, representing time, distinguishes three phases: the early stage when the escalation of conflict takes place; the conflict and war phase; and the last phase of de-escalation of conflict. The vertical axis, representative of the levels of peace or violence, is divided into five phases: Durable Peace, Stable Peace, Unstable Peace, Crisis, and War. The curve also identifies peacebuilding tools that can be used in the different stages in order to prevent, manage or resolve the conflict. These tools, often associated with third-party intervention, include Peacetime Diplomacy or Politics, Preventive Diplomacy, Crisis Diplomacy, Peace Making, Peace Enforcement, Peacekeeping, and Post-Conflict Peace Building. In the scope of this thesis, the term Peace Promotion will be used as the one embracing all the conflict cycle, from conflict prevention to post-conflict peace building.

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[110] United States Institute of Peace (2004). Certificate Course in Conflict Analysis – Chapter 2: The Curve of Conflict. Endowment for the United States Institute of Peace. http://online.usip.org/analysis/2_0_1.php, accessed 03.07.2017

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There are two main takeaways from this graphic: the first one is that conflicts don't emerge out of nowhere, having precursors that can be identified; the second one is that in order to develop effective strategies for the interventions it is essential to understand in which stage the conflict is.

Most of the projects currently developed by the EIP are for conflicts in the crisis/war phase and the EIP focuses on tools for mitigating and terminating the conflict, such as dialogue and mediation. However, many organisations active on the field on Peace, including the USIP, argue that interventions tend to be more effective when they address disputes in the early stage, before these disputes erupt into violence.

A wide range of literature, some of it exposed below, advocates that preventing conflict makes more sense economically and is being considered a priority both by the UN and the EU.

Already two decades ago, the Carnegie Commission on Preventing Deadly Conflict reported that, on average, early, preventive action to avert war and mass atrocities cost 60 times less than late response and military interventions.[111]

The Global Peace Index (GPI) 2017 report sheds some light on the economic impact of violence on the global economy, reporting $14.3 trillion in 2016, equivalent to 12.6% of global GDP, or $1,953 per person.[112] The same report estimates the current ratio of cost of prevention to the cost of doing nothing to be 1:10.[113] Moreover, when comparing the cost of conflict prevention to the cost of conflict, the report states that, if the recommended level of peacebuilding expenditure was reached ($183.7 billion over the next ten years), every dollar invested in peacebuilding would lead to a $16 reduction in the cost of conflict.[114]

Prevention is the central focus of the current United Nations Secretary-General's, António Guterres, ambitious reform program. "Sustaining peace" - a holistic approach to peacebuilding adopted across the UN system in April 2016, and the 2030 Agenda are seen as means to achieve this.[115] Sustaining peace pursues the "implementation of a coherent and coordinated approach to peacebuilding, through strengthening institutions and promoting economic growth and poverty eradication, social development, good governance, gender equality, and respect for, and protection of, human rights and fundamental freedoms". [116] The 2030 Agenda, meanwhile, argues that social, economic, and environmental progress help create conditions for peace. Within this agenda, the adoption of Sustainable Development Goal 16 (SDG 16 – Peace Justice and Strong Institutions) is considered the main measure for "fostering peaceful, just and inclusive societies which are free from fear and violence," and is a connector with sustaining peace.[117]

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111 Carnegie Commission on Preventing Deadly Conflict (1997) *Preventing Deadly Conflict: Final Report*. Carnegie Corporation of New York. http://www.dtic.mil/dtic/tr/fulltext/u2/a372860.pdf, accessed 01.11.2017

112 Institute for Economics & Peace (2017). *Global Peace Index 2017* (p. 58). Institute for Economics & Peace

113 *Ibid*., p. 72.

114 *Ibid*., p. 73.

115 IPI International Peace Institute, https://theglobalobservatory.org/2017/10/the-gambia-an-ideal-case-for-prevention-in-practice/, accessed 01.11.2017

116 *Ibid.*

117 *Ibid.*

The one-year review of EU Global Strategy also mentions the change on the EU's approach to conflict, stating that a stronger emphasis is being put on prevention.[118]

It is therefore, possible to conclude that creating a social investment fund in conflict prevention would be aligned with the UN and the EU's policies and priorities.

On the scope of this thesis and in order to validate this conclusion, interviews were done with two senior officials, one working at the European External Action Service (EEAS) and the other being a senior representative of a network of civil society organisations (CSO's) for peacebuilding and conflict prevention. Both agreed on the advantages of investing in conflict prevention versus conflict resolution and reconstruction. Apart from the economic and financial advantages, the humanitarian advantages and the alignment with EU's structure were also mentioned. From the humanitarian perspective, simply put, prevention allows saving lives. Looking at the alignment with EU's structure, the opinion shared was that the EU's slow response time, due to its decision-making structure, is much more suitable to long-term projects, such as prevention, than to crisis management. Moreover, it was also inferred, that on a global level, there has been a conceptual move from the negative aspect of conflict prevention and peace being the synonym of no war, to the concept of "positive peace" and the advantages it entails. The Institute for Economics and Peace, for example, identifies 8 key pillars of positive peace.[119]

Based on a review of literature and on the interviews held, I conclude that the best option for the use of a social investment fund for EIP, in terms of the conflict phase, is prevention. Moreover, this focus on conflict prevention is aligned with the UN and the EU's policies and priorities.

Nevertheless, despite the recognized importance given to prevention, the reality is that most actions are developed in conflict and post-conflict phases and not in pre-conflict. As explained by one of EIP's Directors, this is due to the fact that pre-conflict actions are more difficult to fund. [120] According to this official, this funding challenge comes from two main sources. One is that by funding an openly known pre-conflict project, the donor is admitting the risk of conflict in that country and this may be considered a risk that neither the donor nor the government where the project is being developed want to take on. The second issue is that funds are limited, and having to choose where to allocate them, funders tend to give priority to current and visible problems versus potential problems. An EIP's program officer also agrees that there is a funding gap in the area of conflict prevention. [121] He considers that the reason for that gap is the fact that it is very difficult to prove the success of these kind of initiatives, in terms of how important they were in avoiding a conflict.

A senior official of the prevention of conflicts division in EEAS, argues that, at the EU level, there is no gap in terms of money, but there is a gap in terms of spending strategy. There is the need for more strategic planning, including mapping and a global view. At the member state level, each has its own

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[118] European Union (2017). *From Shared Vision to Common Action: Implementing the EU Global Strategy - Year 1*. European Union. https://europa.eu/globalstrategy/en/implementing-eu-global-strategy-year-1, accessed 20.10.2017
[119] Institute for Economics & Peace, *op. cit.* p. 81
[120] Van Es, Monique, Programmes Director (EIP), Interview, Brussels, 20 October 2017
[121] Dermendzhiev, Dimitar, Governance and Fundraising Officer (EIP), Interview, Brussels, 10 July 2017

strategy and interest and a funding alignment with those. However, the EU, being an economic giant, lacks a political strategy in terms of development aid. Consequently, the funds are currently being allocated where specific needs of basic services are identified, without a global strategy.[122]

In contrast, a senior representative of a Civil Society Network on Conflict Prevention, claims that there is a funding gap from the EU in the area of conflict prevention and that the demand is higher than the supply.[123] Even though the EU does provide funds to peacebuilding and conflict prevention, the funds are actually set up for crisis management (Security and Defence policy) and there is not enough focus on the conflict prevention at a financial and human resources level. The argument used by this senior representative is that much more funds could be invested in prevention rather than in other areas, such as military actions during and after conflict, which currently have a much higher budget. The EU's Instrument contributing to Stability and Peace (IcSP), the main EU fund for peace building and conflict prevention, has a budget of EUR 2.3billon for the period 2014-2020, which is significantly smaller than other external funding programs, such as the Development Cooperation Instrument (DCI)[124], the European Neighbourhood and Partnership Instrument (ENPI)[125], or the European Development Fund (EDF).[126] In addition, at least 70% of IcSP is dedicated to crisis response, while the long-term part of the instrument related to conflict prevention is the smallest part. Furthermore, the duration of the funding, mostly short-term covering 12 to18 months, is not compatible with conflict prevention projects, which are long-term. Due to this issue, one of the objectives of this CSOs network is to increase the funding that EU provides, especially to CSOs that work in this area, for soft activities they develop in these communities, such as confidence building activities, dialogues, and mediation.[127]

The same senior representative of a Civil Society Network on Conflict Prevention also elaborated on the main challenges faced by organisations fundraising for conflict prevention projects, stating that EU's funding structure excludes small and non-EU based organisations. Several arguments support this statement. The first one is that calls for proposals for few and large grants are not useful for small CSOs developing local activities within the community. Most of the funding for CSOs developing activities in the peace promotion area comes from the Article 4 of IcSP. However, under this Article, the funding process is by call for proposals, mostly for projects requiring large values. The second argument is that the overhead limit covered by EU grants does not cover the actual costs of projects' implementation. As a consequence, only organisations that have other sources of funding for Core activities can sustain themselves while implementing projects funded by the EU. This is, however, not the case for many small CSOs. The third argument is that the complexity of the funding application process excludes local and small CSOs that lack the technical expertise for EU funding applications. The fourth claim is that local and small CSO also lack the technical competences to manage EU grants, complying with all the bureaucracy and strict accounting rules.[128]

[122] Senior official, Prevention of conflicts Division (EEAS), Interview, Brussels, 16 November
[123] Senior representative, Civil Society Network on Conflict Prevention, Interview, Brussels, 20 November 2017
[124] budget of EUR 19.6billon for the period 2014-2020
[125] budget of EUR 15.4billon for the period 2014-2020
[126] budget of EUR 30.5billon for the period 2014-2020
[127] Senior representative, *loc. cit.*
[128] *Ibid.*

Based on the interviews held both with EIP staff and with staff of other organisations linked to the conflict prevention field, this thesis concludes that there is an opportunity for the social investment fund to financially support local projects in the area of conflict prevention that currently do not have access to funding.

When analysing the organisations working in peace promotion, it is possible to identify the current dependency on grants. And although grants will remain as the main source of funding for projects developed in this field and that tend to generate no revenue, it is worth exploring the opportunity that social investment could present by supporting distinct types of initiatives, attracting diverse types of capital and bringing more sustainability to the peace promotion field.

There are numerous organisations working in the peace promotion field, some with a more operational nature, such as the Centre for Humanitarian Dialogue (HD) and the Fund for Peace (FFP), others with a major focus in grant making, such as the Peace Fund.

HD, a well-known private diplomacy organisation, develops its own projects supported by grants and argues that mediation and dialogue are the most effective and cheapest tools to avoid and to solve armed conflicts.[129] FFP is a non-profit organization focused on education and research, whose goal is to prevent violent conflict and promote sustainable security.[130] FFP also develops its own programs that include conflict early warning and assessment and the publication of the Fragile States index.[131] The Peace Fund is a not-for-profit foundation focused on protecting, educating and aiding children living in extraordinarily difficult circumstances.[132]

There are also several funds dedicated to financially support, through grants, projects in the peacebuilding field, throughout all the phases of the conflict. The United Nations Peace Building Fund (PBF), as an example, supports post-conflict peacebuilding initiatives and is focused on the earlier stage of the peacebuilding process when other sources of funding are not available. The PBF funds initiatives from UN agencies and their partners that directly contribute to post-conflict stabilization. The sources of its funding are voluntary contributions from Member States, organizations and individuals.

Despite the diversity of projects developed and supported, the one thing these organisations and funds have in common is their reliance on grants to fund their own projects or to support other organisations' projects. And since grants are not recyclable, the money is used only once, and it has been proved insufficient when compared to the issues it is intended to solve. Grants are indispensable, but they are not a sustainable source of funding. Furthermore, people affected by crisis would usually prefer having the opportunity to contribute to their own future rather than receiving money perceived as charity. Studies also show that, despite the best efforts of many organizations, the architecture surrounding development aid does not contribute to lasting peace in conflict-affected communities[133]. In fact, the aid system tends to undermine the autonomy of local activism, which is

[129] Centre for Humanitarian Dialogue, https://www.hdcentre.org/, accessed 14.10.2017
[130] Fund for Peace, http://global.fundforpeace.org/index.php, accessed 15.10.2017
[131] *Ibid.*
[132] The Peace Fund, https://www.thepeacefund.org/, accessed 14.10.2017
[133] Foundations for Peace Network, http://foundationsforpeace.com/, accessed 20.10.2017

essential to transforming conflicts.[134] Strengthening the resilience of states and societies is also one of the five key priorities of EU's Global Strategy, recognising that fragile states and societies are a priority for conflict prevention. [135]

There is, therefore, an opportunity for a social investment fund to make a difference, by investing in projects that have a social impact in these conflict areas and generate revenue, which promotes and allows the multiplication of these interventions, whilst also empowering and strengthening the resilience of these communities.

As with regards to EIP's capacity to create and manage this fund, experienced social investors mention that the knowledge of the market is key for the success of the investment.[136] And much more important than the knowledge of the social investment market, is the knowledge of the sector or issue that the investee is trying to solve and of the impact expected. The EIP has the knowledge of the peace promotion field thanks to the projects it has developed over the years and it is thus in a privileged position to identify, monitor and evaluate investment opportunities in the field.

Consequently, this thesis' proposal is for EIP to create a social investment fund focused on conflict prevention. This social investment fund would allow the foundation to engage with the actors in potential areas of conflict in an earlier phase, extending the tools used by the Institute to achieve its mission of augmenting global peace.

The following section is focused on the components that will define the investment strategy of this social investment fund in conflict prevention. The contribution, through insightful discussions from EIP staff, including Directors, Program Managers, Officers and Assistants and the Governance Officer, and from external professionals closely linked to peace promotion, was essential to gather a better understanding of the conflict prevention field and explore current gaps where the fund could assist.

134 Foundations for Peace Network *loc. cit.*
135 European Union, *loc. cit.*
136 Abate, *loc. cit*

4 The investment strategy of a social investment fund in the area of Conflict Prevention – applied case to EIP

EVPA's roadmap from *A practical guide to venture philanthropy and social impact* report serves as the backbone for the discussion on the investment strategy of a social investment fund in the area of Conflict Prevention. [137] This discussion is structured in a way that primarily explores each component of the roadmap applied to a fund for conflict prevention managed by any organisation and, secondly, applies the roadmap to EIP, as a practical case.

The investment strategy presented in this thesis for EIP's social investment fund in conflict prevention is not the only possible investment strategy. It is however, the one that best aligns all the information collected about EIP during work at the Institute and the feedback received from EIP's staff.

4.1. Theory of change

EVPA's roadmap does not clearly state the theory of change as one of the 5 main components that define the investment strategy. However, I would suggest adding the definition of the fund's theory of change as the first main component of its investment strategy. The theory of change should describe, in a comprehensive way, how and why a desired change is expected to happen in a specific context. The theory of change should define the long-term goals of the fund and explain the process of change by describing the links between the shorter-term, intermediate, and longer-term outcomes of the initiative. These links should express the rational of why one outcome is thought to be a prerequisite for another.[138] Moreover, the theory of change of the fund should be aligned with the mission of the organisation that is setting it up.

Since the Second World War, there have been more conflicts within states than between states, and the numbers have increased alarmingly since 1989.[139] These internal wars leave permanent marks that are carried over the generations and tend to isolate and alienate individuals and communities.[140] The argument used is that if the violence is erupting from within, the peace initiatives also should emanate from within the community.[141]

In this sense, I would suggest the theory of change of a fund in conflict prevention to clarify how its investments will contribute to the empowerment of the community and consequently to a sustainable peace.

[137] Balbo, P., Boiardi, P., Hehenberger, L, Mortell, D., Oostlander, P. and Vittone, E. (2016). *A practical guide to Venture philanthropy and social impact investment*. European Venture Philanthropy Association. https://evpa.eu.com/knowledge-centre/publications/venture-philanthropy-and-social-impact-investment-a-practical-guide, accessed 01.05.2017

[138] Brest, P. (2010). The Power of Theories of Change. Stanford Social Innovation Review Spring 2010. https://ssir.org/articles/entry/the_power_of_theories_of_change, accessed 12.09.2017

[139] Kilmurray, A. and Knight, B. (2016). *Grantmaking for social justice and peace: approaches drawn from shared practice*. Working Group on Philanthropy for Social Justice and Peace. http://www.grantcraft.org/curated-content/grantmaking-for-social-justice-and-peace-approaches-drawn-from-shared-pract, accessed 30.09.2017

[140] *Ibid.*

[141] *Ibid.*

Applied case to EIP

The fund should be aligned with EIP's mission of contributing to the global peace agenda of Europe, through mediation and dialogue.[142] Moreover, EIP's social investment fund should empower the Institute to better achieve its mission.

Taking these conditions into consideration, the proposed theory of change for EIP's social investment fund in conflict prevention is the following:

Global Peace can only be accomplished when people learn to talk to each other. Conflict is natural and will always exist, but violent conflicts do not have to exist. By empowering the civil society with mediation techniques and by raising the awareness of the power of dialogue, conflict escalation into war can be avoided. By supporting local CSOs that engage with all the distinct groups in a society and promote dialogue and inclusive societies, the fund has the potential to empower societies to overcome their internal tensions and avoid violent civil conflicts within states.

4.2. Investment Focus

The investment focus should be directly related to the fund's theory of change.

As with any fund, it is important to benchmark and to differentiate the focus from other funds or actors in the same field. Hence, defining the investment focus requires significant research into the market or sectors. Moreover, in the specific area of peace, it is essential to be aware of the political dynamics of addressing power relations and the possible reactions it can provoke. [143]

Goal 16 of the SDGs could provide some guidance on the fund investment focus. This goal emphasizes the promotion of peaceful and inclusive societies for sustainable development, the provision of access to justice for all, and building effective, accountable institutions at all levels.[144] It is considered particularly important, because peaceful, just and inclusive societies are necessary to achieve the other SDGs. To achieve peace, justice and inclusion, the SDG 16 identifies three main requirements. The first one is that governments, civil society and communities work together to implement lasting solutions to reduce violence, deliver justice, combat corruption and ensure inclusive participation at all times. The second one is that freedom to express views, in private and in public, must be guaranteed. People must be able to contribute to decisions that affect their lives. Laws and policies must be applied without any form of discrimination. Disputes need to be resolved through functioning political and justice systems. The third and last one is that national and local institutions must be accountable and need to be in place to deliver basic services to families and communities equitably and without the need for bribes.

142 European Institute of Peace, http://www.eip.org/, accessed 20.09.2017
143 Kilmurray, *loc. cit.*
144 United Nations (2017). *Peace, justice, and Strong institutions: Why they matter*. United Nations. http://www.un.org/sustainabledevelopment/wp-content/uploads/2017/01/16-00055p_Why_it_Matters_Goal16_Peace_new_text_Oct26.pdf, accessed 30.10.2017

The investment focus can then be evaluated by the contribution it represents to the promotion of the above requirements.

Applied case to EIP

As this will be the first experience of EIP in social investment, the suggestion is focusing on a very limited number of social sectors and geographies. This strategy will not only facilitate the choice of investments but also its subsequent monitoring and evaluation. EIP's fund focus should nevertheless have a direct link with SDG16.

Moreover, EIP's mission to complement and add value to EU and European peace promotion activities must be taken into consideration when defining the geographic focus.

4.2.1 Social Sector choices

Conflicts have different and varied roots[145] and therefore, preventing them requires a multi-level approach acting at the global, regional, national and local levels of conflict and a multilateral approach by engaging with all key players[146]. In order to address the various root causes and prevent conflicts, the fund could focus on a wide range of social sectors, such as education, security of civil society, renewable energies and information technologies. The opinion from a senior official of the Prevention of Conflicts division in EEAS is to focus on education. The arguments used were that both education and health are important sectors, health being the most important, but education being the one lacking attention.[147] In addition, the senior official of EEAS argues that education is a changing factor for individuals and a capacity builder for societies. [148] Moreover, education has an immense potential to prevent conflict by tacking issues like gender equality or radicalisation. [149]

The suggestion of a senior representative of a Civil Society Network on Conflict Prevention is to focus the fund in different social sectors, depending on the geography's needs and priorities. In each geography, the fund would identify the needs, evaluate the potential to create change or impact, and focus on what is not being already funded by others.[150]

This thesis does intend to suggest which of the above social sectors should be the focus of a conflict prevention fund. However, it argues that a clear investment focus on one particular social sector has multiple advantages, including facilitating impact measurement. Furthermore, knowledge about the specific sector is also of extreme importance to better assist the investee and leverage the organisation's resources.

The European Commission is also focusing their funding programs on fewer topics. As an example, Carlos Moedas, Commissioner for Research, Science and Innovation, announced this October a

[145] Doucey, M. (2011). Understanding the root causes of conflicts: Why it Matters for International Crisis Management. *International Affairs Review* Fall 2011 (Vol 10, No 2, pp 1-10)
[146] European Union, *loc.cit.*
[147] Senior official, *loc. cit.*
[148] *Ibid.*
[149] *Ibid.*
[150] Senior representative, *loc. cit.*

€30billion investment of the European Commission Program Horizon2020 during 2018-2020, mentioning that the program is seeking greater impact of their funding by focusing on fewer topics, but of key importance, namely migration and security, circular economy, clear energy and climate, and the digital economy. [151]

The choice of social sector to invest should take into consideration the fund's theory of change, the limitations and the experience of the organisation managing the fund. Moreover, it should also be appealing to investors in the fund.

In the current context, it is also an added value to clarify how the investment in a specific social sector is aligned with the SDG 16 and will contribute overall to the 2030 Agenda.

Applied case to EIP

The suggestion for EIP's fund is to focus its investments in the education sector. The education sector is directly related with EIP's mission of promoting mediation and dialogue and it is a politically "impartial" sector, crossing all the layers of society and gathering a large interest from social investors. Furthermore, it is the sector where EIP has most experience, gained through the implementation of research and mediation projects, and, as a result, more knowledge of the actors in the sector.

4.2.2 Geographical Choices

When choosing the geographies that will be the target of investment, several factors need to be taken into consideration. One factor is the size of the desired impact of the investment and where its potential is higher. This depends not only on the need of investment, but also on the investment opportunities that are available. A market study is advisable to understand the quantity and quality of potential investments. On the other hand, the knowledge and experience of the organisation managing the investment fund in the geography should also be taken into consideration. Knowing the market will not only facilitate the identification of potential investments but also allow a more accurate assessment of the investment's risk. If the organisation managing the social investment fund already develops or finances projects in specific geographies, it is advisable to align the fund's geographic focus with these.

An additional decision to be taken is regarding the diversity and number of geographies. A reduced number of geographies tends to minimise the costs and the complexity of management, but a higher variety tends to reduce the risk of the investment portfolio.

For some organisations, the geographic focus of their investments is also defined by the nationality of its funds or by the will of their funders. In some cases, the geographic focus is defined even beforehand as part of its mission.

The one-year review of EU's Global Strategy shows an increase in cooperation with EU's neighbour countries and partners, recognizing that events outside EU boarders directly impact EU's own

[151] European Commission- Press Release. (2017) IP/17/4122: Commission to invest €30 billion in new solutions for societal challenges and breakthrough innovation. http://europa.eu/rapid/press-release_IP-17-4122_en.htm, accessed 30.10.2017

security[152]. In term of geographies, the paper mentions the implementation of conflict prevention programs in three continents, explicitly in Ukraine, Libya, Tunisia, Sahel region, Northern Nigeria, Latin-America and the Caribbean. [153]

The interviewed senior official of EES advised a global focus for the fund, with chapter dedicated to different regions, including Africa, Middle East, Asia and Latin America.[154]

The Fund for Peace's *Fragile States Index* could be used as a resource to identify the geographies with higher risk of conflict. This does not mean, however, that this should be the only criteria to be considered. It is essential that the fund manager organisation takes all its characteristics into account, namely its experience and mission, then ultimately focuses the fund on the geographies where it could have the biggest impact and there are investment opportunities.

Applied case to EIP

Most of EIP's projects are implemented in developing countries, hence, these are the markets that the Institute is more familiar with. These are also the geographies where the education sector is more fragile and where consequently the investments could generate a greater impact.

The suggestion of the thesis is for EIP's fund to have a geographic focus in the Middle East and North Africa (MENA) region. Apart from being in the periphery of the EU, this is the region where EIP has developed more projects and where a lot of conflicts have emerged in the last seven years, since the Arab Spring in 2010. Among the countries in this region, the fund would have to evaluate the quantity and quality of potential investments.

4.3. Type of SPO

There is a wide range of Social Purpose Organisations, from charities to social enterprises that generate revenue and socially driven business, as illustrated in the below graphic of EVPA.

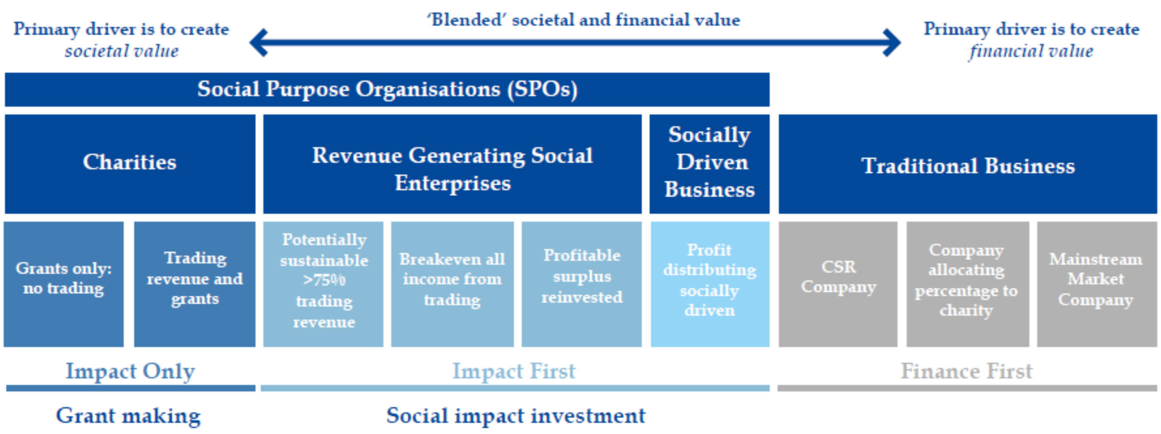

Figure 3. The Investment Spectrum (Source: Balbo, 2016)

[152] European Union, *loc. cit.*
[153] *Ibid.*
[154] Senior official, *loc. cit.*

The difference between the types of SPO comes from the various focus on impact and finance. Charities tend to focus only or mainly on impact and very little, if any, on trading. Thus, any impact investment in charities can rarely expect a financial return. The concept of Revenue Generating Social Enterprises comprises organisations whose main goal is to create impact, but also have a trading component that may ultimately make them profitable. Further away from charities, there are the socially driven business, which are organizations that, although having the creation of societal value as the primary driver, are based on a business that creates profits.

In addition, several impact investors, including funds, are supporting traditional business, whose primary driver is to create financial value. In this context, and although the focus of the investee is not the impact, the social investor may still decide to support the project due to its spillover effects that can go from job creation to financial inclusion or gender equality. The Microfund for Women, for example, provides microloans to women in Jordan who are typically refused by local banks to start or grow their own business. The manager of the fund argues that the impact that they are focused on is the cultural impact in the whole society of empowering women. [155]

Independently of the investment focus of the fund, the choice of the type of SPO to invest in is always limited by the available SPOs looking for investment in the selected sector. Furthermore, this choice should be aligned with the experience of the organisation managing the fund. This argument is supported by the EVPA study that shows that foundations and other venture philanthropists invest more in charities (54%) than in other types of SPOs.

Regarding investments focused in conflict prevention, the network Foundations for Peace defends that sustainable peace building work must be built from within affected communities, societies or countries for it to be sensitive to local needs, effective and progressive and more durable in the longer-term. [156] In this context, it argues that local foundations are in a strong position to develop local peace programmes, whether in partnership with other stakeholder funders or supported by philanthropy or development funds. [157] This thesis defends that the fund should invest in local SPOs.

When deciding in which SPOs to invest, the fund must choose not only the type of SPO, but also its growth stage. EVPA study defines 4 growth stages: 0 years (start-ups); 0-2 years (early stage); 2.1-5 years; and more than 5 years (mature). EVPA states that the investment in early stage organisations is important as these are the ones facing the highest difficulties in attracting funds, partly because they require more patient capital.

The choice of the growth stage and size of the investee is evidently limited by the availability of potential investments in the social sector and geography previously chosen. However, if available, the suggestion for this fund is to invest in early stage organisations.

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[155] European Investment Bank, http://www.eib.org/infocentre/blog/all/womens-microfinance.htm, accessed 16.10.2017
[156] Kilmurray, *loc. cit.*
[157] *Ibid.*

The report *Grantmaking for social justice and peace* sheds some light on what investors in these fields tend to look for in investees. [158] The report mentions, for example, the preference for investees that have an inclusive approach to the problem, exhibited by “Significant participation of women, increased knowledge of environmental threats, and opportunities, increased ability to advocate for just sustainable development policy”. The report also suggests that for these investors it is important that the investee has “a relevant work plan, likely achievements in the short and medium term, and people committed to working on an issue or programme for the long term”. Moreover, these funders highlight the importance of an alignment between the funder’s and the investee’s mission and vision since these tend to be long-term investments and subject to a lot of setbacks. The ability of networking and building partnerships, that may even be cross-sectorial, should also be considered.

When selecting its investees, the fund should also take into consideration the level of risk it is willing to accept. The same report defines 5 types of risk: failure of the program; non- readiness of the grantee; negative public relations; funds not used as intended; and program does more harm than good. [159] As per the data collected for the report, foundations supporting organisations in the areas of social justice and peace tend to have a higher tolerance for the risk of the program’s failure and the ineffectiveness of the grantee. The risks less tolerated are of programs that do more harm than good and of funds not being used as intended. This perspective towards these risks can be easily understood by the context where these programmes are developed, namely in divided societies where the allocation of funds and the impact of funded programs tend to be more closely scrutinized by the public. These insights are extremely valuable for the discussion of a fund in the area of conflict-prevention because this is the context where most of the SPOs that the fund may support operate. Additionally, there is also a significant sensitivity to the risk of negative public reaction since this can have an impact on the financial status of the funder and jeopardize the work being supported. Again, this risk is directly applicable for the fund and for that reason should be taken into consideration in the choice of the investee.

Apart from deciding which type or types of SPOs the fund will invest in, the fund should also define a strategy on how to find these investees.

The fund should define how open to receive applications its funding programs will be or whether the fund manager will be the one researching, and inviting applications from pre-prioritized potential SPOs. Both strategies have pros and cons and obviously the staffing structure of the fund will also influence the approach adopted. The choice of the second approach should depend on the expertise of the fund staff and board member and/or contracted expert advisors On the other hand, as highlighted by some founders in the peacebuilding field, the nature of the programmes supported may impose a narrower approach.[160] An example is given by a human rights philanthropist who pointed out that “most of our grants are confidential because they involve protection”. [161] Another factor to take into consideration is the transparency of the investee selection process, particularly when investing in local

[158] Kilmurray, *loc. cit.*
[159] *Ibid.*
[160] *Ibid.*
[161] *Ibid.*

SPOs. This factor is especially sensitive in pre-conflict contexts, where societies are politically divided, where there is a distrust of civil society organisations or where these organisations are only emerging.

Applied case to EIP

EIP has so far been a 100% operating foundation that works in peace promotion thanks to using grant funding. Hence, the fund would be the first time that EIP would make financial investments.

Another factor to consider is that the work developed by EIP depends a lot on political support. Consequently, the fund would have to be very careful selecting the organisations to support.

Hence, the suggestion for EIP's fund is to start investing in local organisations with a business model similar to EIP's, such as charities and other mission-driven organisations. One example of potential investees are local organisations that promote inclusive dialogue among women's civil society organizations (CSOs) from different ideological, socioeconomic, and generational backgrounds in one of the MENA region countries. Another example would be organisations that arrange community discussions around conflict, brainstorm collaborative solutions and inspire people to seek alternatives to violence. Platforms like the Forum for African Women Educationalists (FAWE) can be used to find local initiatives that could be supported by the fund.

These mission-driven organisations tend to be more politically neutral and have an obvious social driver. Moreover, their business model is easier to be evaluated by EIP. This option has important financial consequences, since these organisations tend to not generate revenue. Therefore, the financial instruments and financial returns of the fund are rather limited.

EIP fund would also be in an advantageous position to fund organisations in the early growth stage due to the patient nature of its capital. In addition, these organisations tend to be small to medium size, which would be in line with the size of EIP. Although representing a higher risk for the fund, early growth stage organisations are often the ones with more need for patient capital and with more difficulties in accessing funds. Therefore, the fund would have a greater impact by supporting organisations in this growth stage than by supporting organisation with a track record and access to other funds.

4.4. Types of financial instruments

The types of financial instrument used for social investment are not different from the ones available for financial investments. And, as with any investment, the instrument used must be adjusted to the type and needs of the business it is supporting.

As explored in section 2.3.2 of this thesis, social investment can be made through a variety of instruments, from guarantees to equity or debt, including a wide range of hybrid instruments such as recoverable grants, forgivable loans and convertible grants and loans. This list and descriptions of the financial instruments does not intend to be exhaustive, but aims instead at clarifying how some of the most popular instruments can be useful at supporting SPOs, depending on their business model and needs. It also includes some examples of how social investors have been using them, sometimes in creative ways.

By providing a guarantee to an SPO, the investor promotes easier access for the SPO to bank loans. The guarantee does not require the investor to make any up-front disbursement, but it can be a very useful tool of social investment, allowing the risk-sharing between the social investor and the bank and so increasing the investee access to mainstream investors.

Loans by social investors are usually provided at or below market rates. This instrument can be used to finance organisations that otherwise would not have access to this kind of financing or that could not bear the market rates. The social investor is, by its nature, more willing to access risks that traditional investors are not, and it is not uncommon to find the interest rates of these loans linked to the social performance of the investee. Debt is often the first instrument used by social investors, which can be explained by its simplicity of use both for the investor and investee.

When investing through equity, the social investor can be paid through dividends or through the sale of its ownership to future investors. It can to be chosen when debt is not a viable financing instrument due to the investee's business model. Equity is however one of the riskiest instruments as it is in the bottom of the capital structure when it comes to repayment. Furthermore, this instrument requires a previously well-planned exit strategy as it has a high impact on the future of the investee. These points help in explaining why this is often not the first instrument used by social investors.

Equity is often referred to as the most expensive source of capital, since its return has no cap. However, because the equity owner shares not only future revenues but also future losses, it can be the best financing solution for high risk SPOs.

Convertible grants, convertible loans and revenue share agreements or quasi-equity are hybrid instruments that have been developed as a variation of equity investments. Convertible grants and loans are, respectively, grants and loans that are provided to the investee and that, under specific conditions may be converted into equity. Convertible loans work as regular loans but with an option to be convertible into equity (either by the investor or the investee). In simple terms, they are advantageous for the investee in case of success of the venture, giving him the opportunity to get additional returns by converting a loan with limited returns into equity, and they reduce the risk for the investee in case of unsuccess, since by converting the loan into equity the investee reduces its liabilities.

Mezzanine finance is an alternative instrument that aims at filling the gap between debt and equity by incorporating both. Structurally, it is subordinate in priority of payment to senior debt, but senior in rank to equity. It can be used when the repayment of the loan is risky and uncertain, allowing the investee to transform the liability into equity or equity interests. Because it is treated as equity in the investee balance sheet, it improves the investee credit rating, making it more attractive to other potential investors. One of the advantages for the investee, when compared to equity, is that through mezzanine finance the investee does not have to provide the investor with collateral, or voting or management rights. However, it tends to be a very costly option for SPOs. It is the highest-risk form of debt but, in commercial finance, offers some of the highest returns (typically between 12% and 20% per year).

One example of mezzanine finance done by social investors is the German European Recovery Programme Special Fund that provides mezzanine capital to enterprises of socially excluded groups, such as women, unemployed or migrants that, due to either insufficient equity or no credit history, are excluded from the traditional financial services. This fund makes investments up to EUR 50,000 for up to 10 years, it requires no collateral and the repayment of the capital is made after seven years in three equal annual instalments. There is a one-time processing fee of 3.5% of the mezzanine capital and during the grace period for repayment of the principle, the enterprise must amortise an annual fixed premium of 8%.[162]

Grants are the financial instrument that supports most charities. They require no repayment or financial return and so one could argue that they should not be considered as a social impact investment instrument. However, it is not uncommon to see social investors using them in their investment strategy together with other instruments. This practice allows for a more adaptable financing strategy to the need of the SPOs. BMW Foundation, for example, states that impact investment complements, rather than replaces, grants. It is an example of foundation that supports businesses both with grants and with social investment, depending on the need of the investee.

In some cases, grants are also used by social investors to decrease the risk for co-investors, that will provide another kind of financing and can thus expect a better risk-return relation.

Recoverable grants and forgivable loans are hybrid instruments that have been developed as a variation of grants that are used mainly by philanthropists or non-profit organisations. Recoverable grants are grants given to an organisation that are converted into loans if the investee reaches a pre-determined result. In case the investee is not successful in reaching that result, the investee does not have to pay anything back. This instrument is often used to provide money for feasibility studies and other pre-development costs before long-term funding sources have been identified. [163] Forgivable loans basically work in an opposite manner. They are loans provided to an investee that represent a financial obligation only if the investee does not reach the pre-determined result. If the investee successfully reaches the result, the loan is converted into a grant and the investee does not have to pay anything back. They can be used as an incentive for the investee to achieve a goal set by the social investor.

Another creative form of grant making that has been used is the format of challenges/competitions, where social investors launch an open call for solutions to solve a specific social problem and award the winner a monetary prize. These competitions serve two purposes: disseminating both the major social problems and the innovative solution; and give visibility to other investors of the high potential of

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[162] Sweco at al. (20169*. Mikromezzaninfonds, Germany - Case Study*. https://www.fi-compass.eu/sites/default/files/publications/case-study_ESF03d_germany.pdf, accessed 12.09.2017
[163] Planet Earth Primer, http://peprimer.com/grantrec.html, accessed 23.09.2017

social investment opportunities. These competitions are also used by some foundations as a tool to find potential investees. Evens Foundation, for example, awards monetary prizes of EUR 25,000 in the categories of Peace Education, Media Education, European Journalism, Arts and Science. They state that the prizes have served to highlight good practices in different fields and, that as a collateral effect, have helped them expanding their network, identifying new challenges, and gaining new insights and perspectives.[164]

The type of instrument used by the fund should be adapted to the organisation it is investing in and to the experience of the social investor. The instruments used by the fund can change over time and it is not rare that social investment funds start by investing in the form of loans before investing in equity.

The nature of the fund itself, in terms of how patient the capital can be and what kind of financial return is expected, may also limit the type of investment. Nevertheless, the SPO need should be the primary factor determining which instruments to use.

Independently of the financial instruments selected, it is important to point out the need for patient capital in the peacebuilding field to be invested over a longer period than some social investors are used to. As an example, the *Grantmaking for social justice and peace* report quotes a funder mentioning their main successes have come through long-term support for the core costs of agencies working on key themes.[165] One of the investments referred to is the Campaign for Freedom on Information that they supported for years, during all the stages, from the research phase to the monitoring of the impact, and that suffered several setbacks before attaining some important milestones.[166]

Applied case to EIP

Taking into account the experience of EIP as an investor, I would recommend its fund to start by using the simplest instruments, such as guarantees, loans, grants and variations of the last two, including bridging loans, forgivable loans and recoverable grants. These are also the type of investments that are usually more needed by charities and organisations in an early phase. Moreover, as long as there is no financial gain for EIP, these investments do not risk being seen as conflicting with the non-profit nature of EIP.

Not-for-profit organisations, such as EIP, often face difficulties accessing the mainstream financial sector. They can hardly get loans from banks or other kind of investors. By providing guarantees to these organisations, the fund would bear the risk of default and consequently promote their access to traditional loans. And for those organisations that cannot afford to pay the market interest rates of loans, the fund could provide loans at below-market rate or at zero interest. Operating foundations, for example, due to their grant dependency, often face cash flow issues. The fund could aim to, through bridging loans, help organisations cover their costs until the grants are received. These grants from

[164] Evens Foundation, http://evensfoundation.be/, accessed 24.09.2017
[165] Kilmurray, *loc. cit.*
[166] *Ibid.*

other donors would then repay the loan and allow the fund to make investments in other social businesses. Since charities and other mission-driven organisations tend to generate little to no revenue, they would pay back the fund when they find alternative sources of funding, such as grants for their core activities or grants for their projects that include an overhead. Some of these mission-driven organisations may also evolve to more financially sustainable models and therefore be able to pay back the fund with future revenues. The aim of the fund, however, would not be to generate financial returns to its investors, but instead to provide patient capital for mission-driven organisations that are in need. These organisations would then pay back the total or part of the amount received once they have a track record and are able to attract other investors. The capital that is recovered by the fund would then be used to support another organisation.

With the above in mind, the suggestion for EIP is to use instruments that are simple to use, useful and adapted for foundations and impact-driven organisations in an early phase of development. Furthermore, EIP's fund would aim at capital preservation in terms of financial returns.

4.5. Co-investing/ co-funding policy

Innovative approaches are needed for addressing social and economic challenges, including new models of public and private partnership that can fund, deliver and scale innovative solutions from the ground up. Co-investment increases the impact potential.

The fund co-investing strategy is also something that should be defined beforehand. And if the decision taken is to co-invest, the people or organisation with whom the fund is investing should be assessed, just as much as the market and the business model are scrutinized before investing.

Below are some key enquiries the fund manager should pursue regarding its co-investors.

The first one is to understand why they are investing. It is important to understand the co-investor motivation, strategy and objectives for the investment to make sure these are aligned with the funds'. Some argue that the best approach is to look for co-investors with similar size and experience since this would guarantee that both have at least the same level of compromise and active involvement towards the investment. On the other hand, some argue that co-investing with someone bigger and more experienced may increase the likelihood that the investment will succeed.

The second one is to analyse their track record. The fund should aim at co-investing with people or organisations that have a proven track record for identifying opportunities and adding value to the investment. These types of investors have access to the most investment opportunities and attract the best social entrepreneurs.

Finally, the fund should also question what type of value a specific co-investor brings to the investment: if the value is related to a specific kind of support the co-investor can provide and the fund cannot; or if instead the co-investor has access to stakeholders that can potentiate the success of the business; or if instead the co-investor is a specialist in securing investments. In the analysis of the type of value brought by the co-investors, it is important to look for complementary skills between investors.

Media Development Investment Fund (MDIF) and the Swedish International Development Cooperation Agency (Sida) are a good example of co-investment. These two social investors have very different profiles, but a long experience working together. MDIF, “a mission-driven investment fund for independent news businesses in countries with a history of media oppression”, has received several grants over recent years from Sida, “a government agency working on behalf of the Swedish parliament and government, with the mission to reduce poverty in the world”. [167] In November 2016, MDIF launched Media Finance I, a loan fund for independent news media companies in specific emerging and frontier markets. The fund provides affordable debt to small- and medium-sized enterprises (SMEs) in the media sector with high social impact. It pays investors a 4% annual coupon and a 55% first-loss protection. The fund represents an innovative partnership between MDIF and Sida, where each organisation provides its skills and expertise. MDIF contributes with its investor experience, gathered over 21 years of investments in 113 independent news businesses in 39 countries. Sida contributes in two ways: directly in the fund by helping MDIF provide investors with the 55% first-loss protection; and providing grants to MDIF so that they can provide strategic advice and management capacity building services to the investees, increasing their potential to succeed. With the structure of this fund, the co-investors aim at attracting private capital for investments in independent media actors.

There are pros and cons of co-investing. Some of the pros are the availability of more funds and the risk sharing. The cons of co-investing may be the increased complexity and duration of decision making and reporting processes, and the risk of misalignment in the investment strategy.

One of the guides to Impact Investing argues that co-investing with more experienced foundations and like-minded investors, may help foundations who are taking the first steps in the social investment field overcome some hurdles. [168] When trying to incorporate best practices from the social investment field into its strategy, foundations may face some push back from its board members with a more rigid view on investment strategies. These more experienced co-investors may help advocate proven approaches to impact investing and share their track-record and experience. [169]

As discussed above in section 2.2 of this thesis, national associations of foundations are becoming key centres for developing resources and sharing best practice. Engaging with these national associations may represent a terrific opportunity to find like-minded investors, who can be potential co-investors.

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[167] Media Development Investment Fund. https://www.mdif.org/mdif-launches-blended-value-loan-fund-with-sida-backed-first-loss-protection/, accessed 14.04.2017

[168] Grantmakers in Health (2011). *Guide to Impact Investing*. Grantmakers in Health. http://www.gih.org/files/usrdoc/GIH_Guide_to_Impact_Investing_FINAL_May_2011.pdf, accessed 12.11.2017

[169] *Ibid.*

Co-investing with local partners can also bring value-add if these local investors have access to a wider local network and so contribute to the identification of potential investments and to an improved reputation.

In order to identify co-investors, it is important to have an overview of the financial resources available in these fragile countries where the fund would invest. The 2016 report *Investments in peace and security* reports that domestic public revenue is the largest resource available to developing countries, being more than twice the size of known international inflows in countries with the highest fragility scores in the Fund for Peace's 2014 Fragile States Index. [170] Among the developing countries, the fact that fragile countries have a lower percentage of domestic spending is justified by the fact that their governments are less able to collect revenue and their domestic private sectors face serious risks and challenges. [171] Official development assistance (ODA) represents a large portion (26%) of total international inflows in countries with the highest fragility scores. [172] For some countries affected by very high levels of instability and conflict, ODA is the dominant international resource – these include Afghanistan (83%), Somalia (73%) and Syria (71%).[173] These numbers highlight the lack of national and local capacity to address the needs of vulnerable people in these fragile contexts. Therefore, private-public partnerships with the local government don't seem to be a co-investing opportunity for a fund dedicated to conflict prevention. However, co-investments with ODA could be a possibility worth exploring.

Applied case to EIP

EIP has had successful experiences in developing projects together with others NGO's, where each organisation contributes with their own expertise and covers their own expenses. However, so far, it has encountered difficulties in pursuing joint-applications for funding. These difficulties come from different views of how the project should be implemented, different availabilities in terms of commitment to the project and different priorities. These are all risks that EIP could face when co-investing.

On one hand, having an experienced co-investor could boost both the buy-in of the fund from EIP's board and the reputation of the fund to attract investments with high impact potential. On the other hand, the fund may need to gain a positive track record before being able to attract such kind of co-investors. One suggestion for EIP would be to start pitching the fund to organisations that currently already provide grants to the institute and are as a result familiar with its work and support projects in the peace promotion field already.

The suggestion is for the fund to look for co-investors with compatible and aligned investment strategies and objectives, but to start investing while these are still being found.

[170] Dalrymple, S. (2016) *Investments in peace and security.* Development Initiatives. http://devinit.org/wp-content/uploads/2016/02/Investments-in-peace-and-security.pdf, accessed 10.10.2017
[171] Dalrymple, *loc. cit.*
[172] *Ibid.*
[173] *Ibid.*

4.6. Non-financial support

Alongside the financial support they provide, social investment and early stage capital, such as venture capital or angel investing, are similar in the additional support they tend to provide to investees. This so called non-financial support can be provided in the form of technical or managerial expertise.

Social ventures recognise this support as being as important as the financial investment, particularly when the investor is an expert on the sector it is investing in. As the president of a firm in which Media Development Loans Fund (MDLF) invested shared: "To me what differentiates [MDLF] is that they help chart the strategy going forward and then help you get there" adding that "also, being media people themselves, they are painfully aware of implementation issues, and are very realistic in their projections". [174]

On the other hand, social investors also seem to be aware of the importance of this non-financial support to guarantee the success of the social venture. Nesta, an independent charity in the UK, investing in innovative social ventures that tackle the major challenges faced by older people, children and communities in the UK, remarks that their support to their investees goes beyond the financing. [175] They claim to provide their investees with expertise and guidance, helping them to grow their reach, demonstrate their impact and become financially sustainable.[176]

EVPA, in its report launched in December 2015 *A practical guide to adding value through non-financial suppor*t, defines non-financial support as the support services provided by investors to SPOs in their three core areas of development: societal impact; organisational resilience; and financial sustainability.[177]

In addition, non-financial support, which sometimes takes the form of mentoring, tends to also include access to a network of stakeholders, such as sector experts and other social ventures and to promote the exposure of the investee.

The report *Grantmaking for Social Justice and Peace: Approaches Drawn from Shared Practice* proposes additional support that can also be provided in the pre-funding phase, namely helping potential investee identifying objectives within the context of a clear theory of change, providing informed feedback on 'expression of interest' applications, or even providing training and capacity building for potential funding applicants.[178]

On a general note, there is no suggestion on what type of additional support the fund should provide. This will have to be decided on the basis of what the fund can provide and the investee at hand

[174] Media Development Investment Fund (2015). *Impact Dashboard 2015*. Media Development Investment Fund Https://www.mdif.org/impact-dashboard-2015/, accessed 08.06.2017
[175] Nesta, *loc. cit.*
[176] *Ibid.*
[177] Boiardi, P. and Hehenberger, L. (2015). *EVPA Report: A Practical Guide to Adding Value through Non-Financial Support*. European Venture Philanthropy Association. https://evpa.eu.com/knowledge-centre/publications/adding-value-through-non-financial-support-a-practical-guide, accessed 01.05.2017
[178] Kilmurray, *loc. cit.*

requires. In addition, the number of investees the fund will support will also determine the amount of resources that can be allocated to each. It is however clear that non-financial support is critical for the success of the investment and it can have particular relevance for local SPOs.

Applied case to EIP

EIP, being an operating foundation, is in a privileged position to provide non-financial support to its investees in all the areas highlighted by the EVPA report.

In terms of societal impact, EIP can help local foundations or impact-driven organisations to develop a sound theory of change and impact measurements. EIP has been developing these for each of the projects it has worked since its creation and its success is reflected in the grants support it has received.

In terms of financial sustainability, EIP's programme and finance teams can support investees developing a fundraising strategy and the EIP's finance team in particular can help them evaluate their revenue strategy and financial model. EIP can also leverage on its experience and provide training to the SPO on how to apply for additional sources of funding.

In terms of organisational resilience, EIP's programme teams can provide human capital support to the SPOs, for example by helping and advising them with their programme's implementation.

Being a rather young operating foundation working in the field of peace promotion, EIP has first-hand experience of the challenges that small organisations working in this field face. Moreover, EIP has the impact driver of sharing its learnings in order to help other organisations grow. Therefore, the non-financial support that can be provided by EIP along with the financial support of its fund, has the potential to have a notable impact on its investees.

4.7. The exit strategy

As with any kind of investment, the exit strategy must be considered as part of the whole investment strategy. It is essential that the fund weighs how the key elements of its investment strategy, defined on the points above, will influence its future exit possibilities and how the exit strategy will guarantee that the SPO will continue pursuing its social impact goals. The last one should be one of the main concerns of the social investor when evaluation different exit strategies. In some cases, the exit plan may even include connecting the SPO to future investors that will ensure the continuation of the impact driver. Furthermore, in order to guarantee a successful exit, it is crucial that the exit plan is co-developed with the investee before the investment is made.

EVPA's *A Short Guide to Exit Planning and Executing an Impactful Exit* publication identifies three steps for planning a successful exit process. [179] The first step is the evaluation of how key factors of the investment plan determine the exit strategy. The investor needs to assess how the social and

[179] Boiardi, P., and Hehenberger, L., (2014). *A Short Guide to Exit Planning and Executing an Impactful Exit*. European Venture Philanthropy Association. https://evpa.eu.com/uploads/publications/VP_in_a_Nutshell_5_exit.pdf, accessed 01.11.2017

economic context in which the investor operates, the type of SPO being supported, the type of funding provided, the social and financial goals of the investor, the co-investors profile and goals and the relationships between investors and investee, will affect its future exit. The second step is the co-development of an exit plan with the investee, including agreeing on the goals and milestones, the timing of the exit, the mode of the exit, and market scenarios for the exit. This should be an upfront discussion and part of the due diligence process of the investment. It is in this stage that the investor and the investee should define the exit based on the SPO's impact objectives. The third step is determining the exit readiness, through the monitoring of the milestones previously agreed. According to the guide, the exit can only be performed if three conditions are met: the SPO is exit ready, meaning that its social impact, financial sustainability and organisational resilience goals are achieved and can be maintained; the SPO is investment ready, which reflects the availability of either the SPO or following investors to take over the investment, guaranteeing its continuity; and the investor feels he no longer adds value to the SPO.

Despite being of extreme importance, the exit strategies are not a subject typically shared by investors, including social investors. However, MDIF did share some details on their exit strategy. The fund clarifies, from the start, to every client in which it invests as an equity partner that when the investee turns a profit it will take its stake out to reinvest in other projects. However, MDIF is careful about the kind of ownership that will be left in place, giving the stakeholders in the investee veto power over to whom the MDLF can sell its shares.

It is worth mentioning that the complexity of the exit strategy also depends on the financial instrument that the fund is using to support the SPO.

Applied case to EIP

EIP must consider all the components of the fund's investment strategy when defining an exit strategy. The sector and geographic focus of the fund, namely in education in the MENA region, influences the exit strategy of the fund, in terms of how and whom to exit, reducing its exit options. Moreover, the fact that the fund will support mainly charities and socially-driven enterprises also limits whom the fund can exit to. In this context, the non-financial support that the fund will provide to the SPO in terms of developing a fundraising strategy and a financial model will be crucial to make the SPO exit ready and increase the potential to find follow-up investors.

The exit strategy also depends on the financial instruments used by the fund, namely guarantees, debt and grants, and the milestone previously agreed for the exit. For an investment in a socially-driven enterprise, the self-sustainability of the SPO may be one of the milestones to determine the exit readiness. If this is the case, the exit strategy may be simple, the investment may end when the debt is paid back or when the donation ends, and require no follow-up investors. But, if the SPO still requires additional funding, it may be part of the fund exit strategy to connect the SPO to other investors and facilitate the transaction. EIP's network and knowledge of the sector are valuable assets for this kind of operation.

If EIP's fund has co-investors, their networks can also be used at the time of exit. It is crucial to align the exit plan and timing of the fund with the co-investor as misalignments may jeopardize the whole investment. This is of special importance for investments in conflict prevention that tend to be long-term.

Finally, EIP's fund exit strategy should guarantee that the investee maintains its impact in the long term and that EIP and the investees preserve a positive working relationship.

5 Synthesis of EIP social investment fund in conflict prevention and next steps

The table below summarises the proposal of the social investment fund on conflict prevention that could be created by EIP.

EIP's fund in Conflict Prevention	
Components	**Thesis suggestion**
Theory of change	Global Peace can only be accomplished when people learn to talk to each other. Conflict are natural and will always exist, but violent conflicts do not have to. By empowering the civil society with mediation techniques and by raising the awareness of the power of dialogue, conflict escalation into war can be avoided. By supporting local CSOs that engage with all the distinct groups in a society and promote dialogue and inclusive societies, the fund has the potential to empower societies to overcome their internal tensions and avoid violent civil conflicts within states.
Investment Focus • Social sector • Geography	• Education/Mediation/ Dialogue • MENA region
Type of SPO	Local Charities/ mission-driven organisations in the early growth stage
Type of financial instrument	Guarantees, loans, grants and variations of the last two, including bridging loans, forgivable loans and recoverable grants
Co-investing policy	Not essential. Experienced social investor or current EIP donors
Non-financial support	Fundraising, theory of change and impact management
Exit strategy	Depending on milestones agreed and financial instrument used. It may evolve supporting the SPO finding additional funds

In order to create the fund there are some practical steps that would need to be taken by EIP, which were not included in EVPA's roadmap. These steps would include the evaluation of the organisational structure that would support and develop the fund and the definition of its management model; the decision about fundraising activities and identification of potential investors for the fund; and the discussion about impact measurements.

In terms of organisational structure, EIP should evaluate how this will be affected by the creation and management of the fund. The current EIP's organisational structure is very well adapted to grants. There are programme teams, divided by grants, and a fundraising and governance officer and a finance and grants manager that support the programme teams in fundraising for the projects, managing the relationship with donors and helping them with the reporting and compliance requirements. The current structure does not have the capacity in terms of workload and investment knowledge to manage a social investment fund. Therefore, a reorganisation of the structure of EIP would need to be considered, especially regarding investment capacity. There are several options and examples available.

In some foundations, investment and finance functions are in one silo and programme activities in another. Investment and finance staff are the ones with the main responsibility to select the investments and monitor the portfolio. The roadmap developed by Lisa Richter of GPS CapitalPartners, which includes the initial strategic planning of impact investment by a foundation, reasons against this model. [180] It highlights the need to identify champions inside the organisation who should be part of the planning team, secure buy-in at the board level and foster buy-in across the organisation. The roadmap stresses the importance of fostering a relationship between the finance and programmes team. It states that constant communication between finance and programme teams will increase the probability of impact investing success by safeguarding that investment strategy aligns both the financial and impact goals.

Some foundations have a team of finance, investment and program staff dedicated to impact investment. This model has the advantages mentioned above but may, however, represent a high cost for the foundation in terms of human resources. Esmée Fairbairn Foundation, for example, up until 2016 had two teams, one dedicated to social investment and one to grant-making. [181] However, nowadays it supports the idea of a single team. The argument used is that the single team model allows the foundation to look at the organisation and all the tools that the foundation has at its disposal to help, allowing them to put the right combination of tools in place, which can be grants or any other social investment instrument.

However, some foundations, particularly the smaller ones, outsource the investment function. They engage external service providers such as an advisor, consultant, or a financial intermediary who has experience in evaluating and monitoring investments.

This thesis argument is that, taking into account the human resources pool and budget of EIP, the last option would be the most suitable to manage EIP's fund, forming a team with finance and programmes staff and outsourcing the investment function. It is crucial, however, to guarantee that all EIP's staff understands the fund's goals so that they can be part of the "sales team" and help identify and promote prospects.

With regards to the size of the fund, my suggestion is to target an initial capital of €0,5 million. This amount is compatible with EIP's experience in terms of budget management and would be enough to initiate the support to various local early growth stage organisations in the MENA region. This capital would be used to make investments from €5,000 to €20,000. Since these investments would not generate financial return and are highly risky, the perspective would be for the fund to have a life span of 20 to 30 years.

[180] Grantmakers in Health, *loc. cit.*
[181] Abate, *loc. cit.*

A very crucial step is the decision about fundraising activities and the identification of potential investors for the fund. Social investment funds, in general, have different types of investors. Fund managers, DFIs, Financial institutions, Pension Funds and Insurance companies, Foundations, individual investors or NGOs. These investors however have different expectations regarding the impact and the financial returns and these should be taken into consideration during the fundraising activities.

In terms of sources of capital, 135 social fund managers reported that 24% of their funds were raised from pension funds/insurance companies and 18% by family offices/High net worth individuals (HNWIs).[182] And, although 61% reported to have raised some capital from foundations, they only represent 6% of their assets under management (AUM).[183] However, the sources of capital vary a lot depending on the size of the fund. For smaller funds[184], family offices/HNWIs represent the main investors (30%), followed by DFI (19%) and foundations (14%)[185]. Moreover, the sources of capital also vary by asset class focus and target returns. For private debt-focused fund managers, retail investors represent 21% of their sources of capital. For fund managers seeking below market returns, foundations are the third biggest investor (14%).

Considering the characteristics of EIP's fund, being small, focused on debt instruments and targeting capital preservation in terms of financial returns, its fundraising activities should be directed to HNWIs and foundations, with a higher focus on impact. Another alternative would be to try reaching retail social investors through intermediates such as crowdfunding platforms.

The 2017 GIIN report also shares information relevant for fundraising activities that can be used by EIP, such as the factors that investors consider more important when evaluating fund managers and the performance track of investments regarding the SDGs. Impact potential was reported as a very important factor by 71% of the respondents, followed by the sector expertise (64%)[186]. SDGs seem to have a substantial influence of impact investors, since 26% reported to have actively tracked and 33% plan to track the performance of some or all their investments with regards to the SDGs during 2017[187]. Therefore, during its fundraising activities for the fund, EIP should emphasize on the sector expertise that the foundation holds, the fund impact potential and alignment with the SDG16. Furthermore, it should also highlight how its investments contribute to the achievement of other SDGs that are the main focus of social impact investors, such as SDG8: Good Jobs and Economic Growth and SDG5: Gender Equality.

Last, but not least, it is important to monitor the performance of the fund's investments, making sure they are aligned with the foundation's objectives and target impact. But, unlike traditional investors that only measure their financial returns, the fund needs to track both the financial and social impact performance of its investments. And while the financial performance of an investment is relatively

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182 Mudaliar, *2017 Annual Impact Investor Survey*, *loc. cit.*
183 *Ibid.*
184 Small funds have, in average, a total of AUM of USD 40 million
185 Mudaliar, *2017 Annual Impact Investor Survey*, *loc. cit.*
186 *Ibid.*
187 *Ibid.*

straightforward to measure, focused on indicators such as profit, cash flow and balance sheet strength, measuring social impact is not that linear. Some social investors include key programmatic or social indicators in the investment agreement on which investees must regularly report[188]. Some examples of these metrics are jobs created, numbers of individuals accessing financial services or levels of energy conservation achieved, to name a few. Recently, in order to promote transparency, ease reporting load on investees and aid investors selecting and monitoring their investments, there has been a lot of focus on standardizing impact measures. One result of this focus was the creation, by Global Impact Investing Network (GIIN), of Impact Reporting and Investment Standards (IRIS). IRIS, a catalogue of standardized definitions for performance measures by sector, aims at easing the comparison of investments across a portfolio and industry-wide. Many other organisations have developed their own metrics, which can be used by EIP. B Analytics, as another example, developed GIIRS Ratings, providing standard metrics for funds to manage their portfolio's impact. GIIRS Fund Ratings include three parts: an overall Impact Business Model Rating, an overall Operations Ratings and a Fund Manager Assessment. Toniic, a global community of impact investors, has also developed metrics for investments in early-stage social enterprises. EIP should look into these different impact measurement models, and either adopt them to its fund or use them as an inspiration to create its own model. These should, however, be defined before the fund starts investing since the specific financial and impact measures and the frequency of reporting are to be laid out in the investment agreements between the fund and the investees. It is recommended that the monitoring, of both financial and impact performance is done at least on an annual basis[189]. The financial monitoring should focus on the investee's likely capability to repay the investment. Moreover, for management and accounting purposes, the fund should regularly evaluate the risk of default by the investee, hence, the fund should also define a risk rating system.

Annex 2 illustrates the different components of the investment strategy for the social investment fund.

Other things that are not in the scope of this thesis, but would need to be taken into consideration by the EIP, include the legal structure and the fund's management fees. The choice was to focus the thesis on the investment strategy of the fund, instead of covering all operational details, however, these are critical for the fund design and remain to be studied.

[188] Berliner, *loc. cit.*
[189] *Ibid.*

6 Conclusion

The context in which American and European Foundations operate is very different. The rich diversity within European foundations is a consequence of the various models of civil society, the numerous legal frameworks and the different role the state plays in each country. Despite the differences between them, foundations have played a significant role in the development and strengthening of European societies and they have been doing so using a diverse range of methodologies complementary to grant making. The focus of foundations is always to achieve their mission and create the biggest impact.

European Foundations are going beyond grant making and are engaging with social investment in many ways. Some are making direct investments in other charities or in social enterprises. Others are engaging through SIBs or DIBs. Some foundations are developing challenges and providing prizes to the most innovative social ventures. Some others are supporting the creation of hubs and incubators dedicated to help social ventures strive. Foundations may have distinct motivations to engage with social investment. It is, however, possible to conclude that they are in a strong position to support the development of social investment.

Social investors, including foundations, have different profiles and expectations regarding their investments' returns. Social investment can be done using a wide range of financial instruments, but the non-financial support is also key to the success of investees. Despite the encouraging growth trends and impact potential of social investment, it is important to note that it is still a niche market in most developed countries, there is still limited evidence of its financial performance and it is far from comparable to other asset classes. In terms of trends in social investment, the 17 SDGs are evolving as a reference for those who seek to make investments that create impact.

This study concluded that operating foundations can engage with social investment and leverage their expertise through the creation of a social investment fund. Moreover, it presented evidences that creating a social investment fund in conflict prevention would be aligned with the UN and the EU's policies and priorities. Because there is a funding gap for small and non-EU SPOs, there is an opportunity for the social investment fund to support local projects in conflict prevention. Moreover, social investment represents an alternative to grant-making by supporting projects that have a social impact in these conflict areas and that generate revenue, which allows the multiplication of these investments, along with the empowerment and resilience of these communities.

It makes sense for the EIP to create this social investment fund in conflict prevention since the foundation has the required experience and knowledge of the field. In addition, the non-financial support that can be provided by EIP along with the financial support of its fund, has the potential to have a notable impact for its investees.

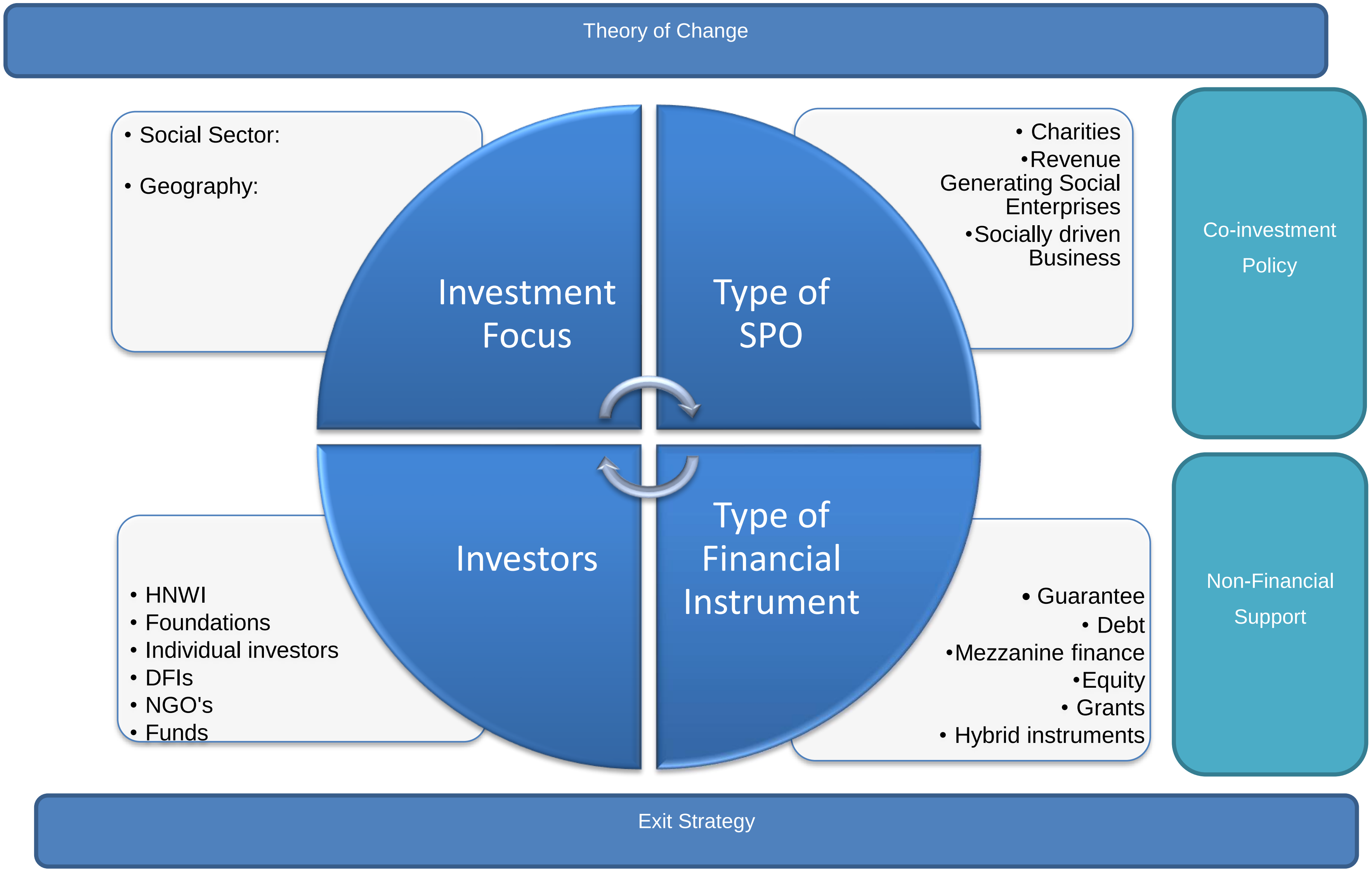
This social investment fund would allow the foundation to engage with the actors in potential areas of conflict in an earlier phase, extending the tools used by the Institute to achieve its mission of augmenting global peace.

Annexes

Annex 1: Summary Table of European civil society organizations models

Model	Relationship with government and church	Fiscal and legal climate	Perception of voluntary work
Anglo-Saxon	SCO are counterweight – critics and advocates of reform. Foundations support SCO and fund projects that the government does not.	Enabling legal and fiscal infrastructure that encourages donations and gifts	Strong culture of volunteerism
Rhine	Strong SCO's that tend to be subcontractors funded by the government, in healthcare and education sectors. Foundations have not been recognized as important players until recently	Fiscal and legal climate does not encourage donations and gifts	
Latin/Mediterranean	The state has a strong role and there is a clear division between state, provider of good and services, and church, provider of charity. Foundations are confronted by the government when trying to provide complementary support to the society	Fiscal and legal climate does not encourage donations and gifts	Volunteerism is perceived as a treat to the job market
Scandinavian	Strong welfare state. In their complementary role, CSOs tend to provide innovative solutions for the existing problems, which are later adopted by the government Foundations work closely with the government.	Gifts and donations are not strongly promoted in the fiscal system.	Personal initiative is viewed as positive and volunteerism is a powerful force

Annex 2: Components of the investment strategy for the social investment fund



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