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Private Social Investment in France: Meeting Two Goals

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Social investing is *en vogue.* As the investment landscape evolves, investors are looking increasingly toward non-conventional assets that satisfy a more complicated objective: earning returns while promoting positive social impact. Motivated by a desire to help those in need, contributors who want to see their funds used in a sustainable and accountable way have found that private social investing meets both these goals.

At the end of 2009, social investing in France reached €4 trillion (US$5.7 trillion) after nearly doubling between 2005 and 2008. The dominant investment vehicles in this field are socially responsible index funds. The leading investors, initially religious organizations, are now high-net-worth individuals, foundations and even institutional investors, a reflection of the domain's greater visibility and the increased access to social-impact investment institutions.

According to Novethic, an affiliate of government pension fund manager Caisse des Dépôts, social investing in France is still in its fledgling stage, but it has been encouraged by French legislation that promotes social investing, such as a regulation requiring pension funds to invest at least 10% of their assets in socially conscious projects. The potential of this domain in France is further demonstrated by the recent entrance of financial institutions that formerly valued only the economic "bottom line," such as the "Club of Six," comprising prestigious French banks with assets over €1.5 trillion (US$2.1 trillion).

Against the background of this growth in socially responsible investing, which is dominated by specialty index funds, the field of private social investment in France started in the late 1990s. While public social investing is recent but increasingly accepted, private social investing is brand new and just starting to gain traction. Matt Christensen, Executive Director of Eurosif, a European think tank for sustainable investment, notes that "the challenge in the past has been that many French investors traditionally viewed social venture as a role for the State rather than a role for private investment.... [I]nvestors are [now] better understanding that this form of investment can be done through private capital more efficiently than with public capital. The French social venture capital market is poised to grow significantly in the coming years as the 'impact investor' movement has taken off in the U.S. and U.K."

Two Styles of Investing

Two main approaches to private social investing emerged: location-agnostic investing in social enterprises, such as PhiTrust Partenaires, and providing capital to profit-seeking small and medium enterprises (SMEs) in underprivileged areas. The latter category is divided into community redevelopment funds that focus on economically depressed French suburbs and emerging market private equity funds. This category of funds considers private-sector investments that facilitate job creation and human capital development, to be social in their own right. Bac Partenaires and Citizen Capital represent the former sort of fund, whereas Investisseur et Partenaire pour le Développement (I&P) focuses on emerging markets.

The two styles of investing are illustrated by I&P and PhiTrust. These two firms' approaches show signs of evolving in different, though equally promising, directions, thus offering alternative models of understanding and implementing social investing activities. I&P focuses on profit-generating investments in SMEs in developing economies, while PhiTrust generally funds social-impact projects primarily in developed markets.

PhiTrust, based in Paris, is an asset-management firm offering a multi-faceted approach to social investment. The company seeks "double bottom line" returns on its investments, combining financial and extra-financial objectives -- such as governance, environmental concerns, and social impact -- in each project. The firm has three arms: socially responsible mutual funds, a social venture capital fund called PhiTrust Partenaires and a grant-making foundation called La Fondation PhiTrust.

PhiTrust Partenaires supports social entrepreneurs by applying market-based methodologies to investments structured similarly to venture capital, but with the additional requirement of both financial and social returns. "We demand a double return on our investments," says Florence Goudchaux, director of project analysis at PhiTrust Partenaires. "We are looking for projects that are ... financially sustainable and make a strong social impact."

Not only are the objectives different from traditional venture capital, but the scale is also considerably smaller. As of June 2010, PhiTrust Partenaires's fund was €7 million (US$9.8 million), the average investment was €300,000-500,000 (US$420,000 -- 700,000) and the target return on investment (ROI) was 5% (the firm has yet to exit an investment). PhiTrust Partenaires partners with a variety of actors in the field, such as co-investments with the corporate social responsibility (CSR) arm of Groupe Danone, investing in I&P to contribute to developing country projects, and financing schemes that have also historically received foundation funding. "The Partenaires fund's aim is to show investors that there is a for-profit sector that can achieve financial sustainability," notes Devin Blondes, a financial analyst at PhiTrust Partenaires. "The fund also wants to show investors that it can accomplish this through economic activity, whether that is through its employees, its services, the goods it produces or its social and/or environmental impact."

PhiTrust Partenaires manages risk by choosing businesses with proven track records of accomplishment to maintain a higher probability of success. When the opportunity arises, the company also helps non-profits develop for-profit arms. In these cases, says Blondes, "we give [financing] to encourage the creation of a sustainable for-profit company that will help the Association further its mission. The business plan we design aims at financial sustainability, which will lead to sufficient profit fed back to the Association for it to achieve financial independence."

PhiTrust Partenaires employs a "bottom-up" approach of targeting high-quality projects led by social entrepreneurs, mostly in Europe and in Francophone developing countries. Project selection also includes an audit and review by the investment committee. According to Goudchaux, "the committee tries to choose projects in areas where someone around the table has an expertise, so that person can take the lead advisory role." After the investment is approved, that expert guides the portfolio company in developing tactical and strategic plans in addition to measuring the financial and social impacts resulting from operations. For the duration of the investment, the target company provides regular reports on operational activity, as well as financial, social, and environmental impacts. Social metrics are distinct and non-standard among individual investments. Goudchaux notes: "In our opinion, there is no way to compare the impact of an organization that employs the mentally handicapped with one that helps poverty-stricken farmers in Senegal through sustainable milk production."

Two projects from PhiTrust Partenaires' portfolio show the vibrancy of social investing in France. The first project, Ethical Property Europe, rents environmentally responsible office space to associations and non-profit organizations. Following a successful first year in Belgium, the company sought to expand its model across continental Europe. In 2009, the firm realized a profit of €524,000 (US$734,000) and met a social objective of providing office space for 44 non-profit organizations. Since non-profits are likely to place a higher value on environmentally responsible office space than other organizations do, Ethical Property Europe is able to concurrently fill a market niche and realize profits. This approach enters precisely into PhiTrust Partenaires' investment philosophy, which emphasizes filling social needs through profitable models.

Ecodair, the second project, seeks to integrate mentally handicapped individuals into the workforce by employing them to refurbish used information technology materials. The company initially received funding from La Fondation PhiTrust as a non-profit but later incorporated two for-profit social enterprises, into which PhiTrust Partenaires then invested capital. "At the moment, Ecodair is the only Partenaires investment that also received Foundation funding," Blondes says. "The grant was made to their Association to assist it in setting up two for-profit companies. We then invested capital and debt in each of the two companies."

Although Ecodair realized a loss of €9,000 (US$126,000) in 2009, the number of handicapped employees increased from 38 in 2008 to 46 in 2009. Ecodair may continue to struggle with profitability, because its principal objective is to employ a maximum number of handicapped workers. However, the company fills a social need that would otherwise not be met by the market, because mentally handicapped workers are less likely to find employment. PhiTrust Partenaires maintains a high risk tolerance for investments with long time horizons for profitability, provided these investments respond to a social need that would otherwise remain unfilled by the private sector.

"In the case of Ecodair, we know that our investment will be longer-term as we need to develop the company enough for it to become sustainable," says Blondes. "The cases that will necessitate funding from the Foundation can be expected to take longer to mature before we consider an exit. Ecodair is a company on which we expect low return, but this would not necessarily be the case if we were to make other [investments with funding from both the VC Fund and the Foundation]." To date, Ecodair is PhiTrust Partenaires' only project that has previously received foundation funding.

PhiTrust Partenaires' main strengths are its strong network of sophisticated investors with social interests, who serve as both investors and advisors to portfolio companies, and its extensive social enterprise network, which facilitates investment selection. Projects are geographically close enough for investment committee members to act as expert consultants, thereby allowing PhiTrust Partenaires to avoid the costs associated with hiring technical specialists. The company's main weakness is its low historical returns, which limit the pool of potential investors, and hence its potential social impact.

Given PhiTrust Partenaires' target ROI of 5%, investors motivated by economic returns will generally prefer to invest elsewhere. Furthermore, the long time horizon of the investments, in conjunction with the anticipated returns and relative illiquidity, is less attractive than other investments. PhiTrust Partenaires is threatened by competitors that present social-investment alternatives to their social venture capital model, such as a growing number of socially responsible index funds in France. In addition, the heavy involvement of investors may become untenable as the investor pool grows. Lastly, non-standard social metrics do not allow for a comparison among investments' social returns. However, the development of this sector offers the opportunity to attract new investors to PhiTrust Partenaires. A recent French regulation requiring pension funds to invest at least 10% of their assets in socially responsible investments and the potential for future similar legislation represent a growing opportunity for asset-gathering from French institutional investors.

The venture capital-based model provides a powerful new way to raise capital and provide management expertise to organizations responding to social needs, as well as a dynamic way of cooperating with the CSR missions of large firms. As foundation management and grant-making become increasingly impact- and metrics-focused, this model could emerge as a new way of managing diverse, private-sector-oriented charitable giving and outcome management, as long as firms like PhiTrust Partenaires adopt a long-term perspective, have high risk tolerance, and emphasize the social aims of its portfolio companies.

Investing in Africa

Another organization in the social investing sphere is the private investment company Investisseur et Partenaire pour le Développement (I&P), founded in 2002. I&P invests in SMEs and microfinance institutions (MFIs) in African countries and supplements its capital investment with technical assistance. I&P's investments are managed by I&P Etudes et Conseils, its management company.

I&P invests in high-potential private enterprises in developing countries, particularly in West and Central Africa. In September 2009, the company's portfolio had grown by 45% to €14.1 million (US$19.7 million) , comprising 19 SMEs and 4 MFIs in 13 countries. The firm's average funding level is between €200,000 and €800,000 (US$280,000 and US$1,120,000), with an investment horizon of five to seven years.

In I&P's case, investment in small and medium-sized profit-seeking enterprises is considered a social investment insofar as these are companies located in African countries that contribute to local development, job creation and the growth of a "mezzanine" private sector.

"We invest in French-speaking African countries such a as Niger, Mali or Senegal," says Sebastian Boye, investment director at I&P. "These countries are among the poorest and have a particularly weak SME landscape. This lack of development of SMEs is not due to a lack of talented entrepreneurs. They do exist but they have very few tools to help them. Local banks do not finance SMEs, or very exceptionally only with strong collateral. They focus on big companies and projects. I&P is focusing its investments in the so called 'missing middle.' We consider encouraging SMEs to have social benefit, but these projects are not 'social businesses' per se."

I&P also applies a negative screen to its investment, only investing in those projects that are considered to add value to the local economy. While this screening process is ad hoc, in the past I&P has rejected investments that are focused on importing foreign goods (as opposed to those focused on the development of local industry), and also micro-finance institutions that charge high commercial interest rates.

I&P takes a bottom-up approach in selecting SMEs for investment. It acquires minority equity stakes, thereby taking an active role in the governance of its partner enterprises, and commits to empowering the entrepreneur and the local team. "We never replace the CEO," says Boye. "We are investing in the person." I&P provides a broad range of services to portfolio companies to maximize performance. This typically includes strengthening governance structures, establishing or improving accounting and management practices, providing strategic direction and engaging consultants for specific projects. The latter is partly subsidized by grants from foundations or development organizations. By the end of fiscal year 2009, I&P had invested in a total of 23 businesses and institutions and had successfully exited 2 investments, each of which yielded returns in excess of 20%. I&P expects an average return of 10% to 15% on its portfolio.

With respect to MFIs, I&P employs a similar approach in terms of technical assistance by acquiring equity stakes and promoting growth in the scale and services of MFIs in developing countries. In these countries, and especially in Africa, the formal banking sector only serves a small minority of the population," says Boye. "MFIs bring financial services to microentrepreneurs, mostly in urban areas. The amounts lent by MFIs can vary but typically [range from] US$50 to US$2,000. I&P considers MFIs to be a specific kind of SME." The current portfolio includes stakes in MFIs in Uganda, Côte d'Ivoire and Cameroon. I&P ceded its stake in the Mexican MFI Semisol in 2009 following a five-year engagement.

Two of I&P's projects illustrate its social impact. The Mexican MFI Semisol was founded in 2004, when I&P entered as a majority shareholder. Between 2005 and 2009, Semisol increased its client base sevenfold, created a regional network of five agencies, and employed 75 people. In addition, between 2007 and 2008, the company's net profit increased by 53%. As a result, in 2009 I&P sold its position under favorable terms to Apoyo Integral Inversiones, a consortium of two specialized microfinance investors, and to a Salvadorian company. Subsequently, I&P decided to focus on microfinance investments located exclusively in Africa, where it thought it could maximize social impact.

The second project involves Cameroun Breuvages, a West African company that packages and distributes water in plastic pouches, responding to a local difficulty in accessing potable water. I&P had a multi-faceted role in developing Cameroun Breuvages, providing both funding through equity and debt investments, and managerial and technical assistance. In addition, I&P raised capital for the company from another investor. By the end of 2009, the company's revenues, distribution network and product offerings grew significantly, with sales of over 15 million units.

I&P helps its portfolio company improve performance by providing advice on product offerings and helping develop managerial skills. "Guidance and accompaniment are extremely important factors in the success of our portfolio companies," says Boye.

Given the relatively higher risk and lower return profile of its investments, I&P's main weakness is an unattractive risk-return ratio for profit-seeking investors. Nevertheless, the company is poised to become a market leader. As I&P grows and the social investing space develops further, the company may face the challenge of identifying the appropriate performance measurement metrics and benchmarks for a non-traditional investment product.

The social investment landscape in France today is becoming increasingly sophisticated and complex. PhiTrust Partenaires' social venture capital model and I&P's emerging-markets private equity model represent two evolving and distinct ways of approaching social investment. While the former model may turn into a prominent way to bring funding and expert management practices to organizations addressing social issues, the latter has the potential to encourage sustainable economic growth in developing countries. Just as microfinance emerged as a new and powerful approach adopted by charities, investors and development organizations alike, I&P's private equity model has the potential for attracting a wide variety of investors.

The remaining challenge for the social investing sector is the development of demonstrable and comparable social impact metrics or a benchmark that will facilitate evaluation of the social impact of different investment schemes. If such metrics were currently available, investors could rank and compare investments on the basis of potential social impact, thereby reducing the information asymmetry surrounding social benefits. There may indeed be a convergence of the social venture capital model and the emerging-markets private equity model as the establishment of standardized social impact metrics facilitates the comparability of investments pursued by both business models. Thus, investors would be able to remain agnostic to the specific model employed when analyzing potential social investments, enlarging the universe of social impact opportunities that are available.

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