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Upfront

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INVESTING

The Benefit of Doing Good

The 'social discount' may not be as steep as investors think

Can investing in social purpose business generate an attractive financial return?

That was the question posed in a new study of investments made through Investors' Circle (IC), a Brookline, Mass.-based nonprofit network of individual "angel" investors that funds social purpose startups.

Stacey Childress, executive director and senior researcher at the Initiative on Social Enterprise at Harvard Business School, and Olive Darragh, a director in McKinsey & Company's Boston office, fielded a team of MBA students to gather data on 110 of 128 investments between 1991 and 2001. Those investments totaled $80 million, including success stories like Sonic Innovations, a maker of hearing aids that went public in May 2000; Earth's Best, an organic baby food maker purchased by the H.J. Heinz Company; and Energia Global International, a Latin American renewable energy company. IC members made investments ranging from $10,000 to as much as $6 million.

While conventional wisdom suggests that social purpose investing occurs at the expense of financial returns, Childress said, "Some in the social investing community believe passionately that this is simply untrue" Her research was designed to move beyond anecdotal investor experience to assess the so-called "social discount."

To determine how financial returns from social purpose investments compare to traditional market investments, the study created two hypothetical portfolios containing the 110 IC companies based on two investment strategies: A "buy and hold" model, in which individuals invest money in the first round but not thereafter; and a "buy and sell" model, in which investors participated in all follow-up funding rounds and then sold stakes six months later.

The study revealed that social purpose startups can generate returns that compete with investments in the S&P 500. While the hypothetical buy and hold model generated a return of 8 percent, the buy and sell model generated a 14 percent return – exceeding the S&P 500 Index average for the same period by 3 percent.

"This study has provided evidence that venture investments can perform at a high level both socially and financially," says team member Hank Midgley.

The study also found that social purpose startups perform similarly to those traditionally funded by venture capitalists: They tend to fail about as often, and returns typically depend on a few tremendous successes. However, these companies do have more trouble achieving "liquidity events" – only 15 percent of IC companies have been purchased or have sold shares in initial public offerings.

–Michael Fitzgerald