



# LASTING IMPACT: THE NEED FOR RESPONSIBLE EXITS

**GIIN** ISSUE BRIEF



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Dear Reader,

Impact investing requires the foresight to envision the transformation of capital into positive change in people's lives and protection of the environment we share. Though such transformation largely occurs during the life of an investment, it does not end there. Impact investors expect the impact of their investments to extend even after they exit.

I am very pleased to share this report, *Lasting Impact: The Need for Responsible Exits*, which reveals insights into how impact investors enable the organizations and projects they finance to expand and deepen their impact beyond the duration of their investment. The report describes a variety of approaches taken by investors—to select, manage, and ultimately exit their investments responsibly.

Perhaps not surprisingly, steps to ensure a responsible exit can be taken throughout the investment lifecycle. Prior to investing, many impact investors seek to understand whether impact is deeply embedded in company business models or operational practices. Practitioners also factor lasting impact into the structure of their deals; aspects such as time horizons and repayment conditions often influence investee strategy and growth expectations in ways that may affect sustainability. Further, investors seek alignment with co-investors so that strategic decisions take mission preservation into account. Once invested, some investors work with company management to instill policies and practices that ensure positive impact continues into the long-term. Of course, specific decisions at the time of the exit itself also affect impact, including timing the exit, retaining investee management, and selecting aligned buyers.

I urge investors to read this report as inspiration for considering their role in creating long-term, wide-reaching, positive impact. Investments, after all, are made for the future.

As the impact investing industry grows and investors gain more experience with exits, the practices explored here will continue to develop, and new practices will also emerge. It is our hope—and belief—that the development and adoption of such practices will lead to better assurance of long-term impact, which is vital for the industry and the world.



A handwritten signature in black ink, appearing to read 'Abhilash'.

Abhilash Mudaliar

*Research Director, Global Impact Investing Network*

## **ABOUT THE GLOBAL IMPACT INVESTING NETWORK**

The Global Impact Investing Network (GIIN) is a nonprofit organization dedicated to increasing the scale and effectiveness of impact investing around the world. The GIIN builds critical infrastructure and supports activities, education, and research that help accelerate the development of a coherent impact investing industry. For more information, see [www.thegiin.org](http://www.thegiin.org).

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# Table of Contents

<b>Executive Summary</b> .....	<b>2</b>
<b>Introduction</b> .....	<b>3</b>
<b>The need for responsible exits in impact investing</b> .....	<b>4</b>
<b>Approaches to responsible exits throughout the investment lifecycle</b> .....	<b>6</b>
Pre-investment .....	7
At the time of investment .....	8
During investment management .....	12
At the time of exit .....	12
After exit .....	16
<b>Achieving financial return objectives and impact</b> .....	<b>17</b>
<b>Conclusion</b> .....	<b>18</b>
<b>Case studies</b> .....	<b>19</b>
Adobe Capital's exit from Natgas .....	19
Lok Capital's exit from a microfinance company .....	22
Beartooth Capital's exit from Montana ranchland .....	25
LeapFrog's exit from Express Life .....	28
<b>Appendix 1. Interviewees</b> .....	<b>31</b>
<b>Appendix 2. References</b> .....	<b>32</b>
<b>Appendix 3. Summaries of relevant literature</b> .....	<b>33</b>

# Executive Summary

Impact investors intentionally select and manage investments to generate positive social or environmental impact, or both. The maturation of both the field and investors' portfolios has drawn increased attention to exits, especially how investors attempt to safeguard the continuity of impact beyond exit. There are a range of risks associated with exit—such as those related to mission drift and business failure—which a responsible exit can mitigate to ensure the investment makes a lasting impact.

This report outlines impact investors' approaches to achieving responsible exits, drawing insights from interviews with more than 30 investors and entrepreneurs and a review of existing resources on the topic. Impact investors use various methods across all stages of the investment lifecycle to increase the likelihood that the impact they seek will continue and grow after they exit the investment.

## 1. PRE-INVESTMENT

## 2. AT THE TIME OF INVESTMENT

## 3. DURING INVESTMENT

## 4. AT THE TIME OF EXIT

- 1. Pre-investment:** It is widely accepted that the foundations for a responsible exit are laid even before an investment is made. To increase the likelihood of continued impact after exit, investors often select investees based on whether impact is embedded in their business model or inextricably linked to financial success. They also seek to understand the likely growth trajectory of the business, which has implications for which exit paths and options will become available. Founders' commitment to mission is yet another pre-investment consideration.
- 2. At the time of investment:** The very structure of the capital provided can affect whether a business will be able to follow a sustainable growth path that leads to long-term success, as aspects like time horizon for return or repayment influence business decisions. Two additional considerations at this stage include alignment with co-investors on impact and growth strategy and the inclusion of language on impact in legal structures and documents.
- 3. During investment:** Some investors work with management to instill positive policies and practices for the long-term, such as those that govern employment, sourcing of raw materials, or customer service.
- 4. At the time of exit:** This is, of course, a critical phase. First, timing is key, since impact investors' objectives at exit extend beyond their own financial success to include a company's continued access to the right resources, networks, and knowledge. A related consideration is to select the right buyer—one who not only offers resources for the investee to grow and improve but who also understands the value in the business model and shares a vision for growth alongside sustained impact.

Four case studies of these various methods as applied to investments in a natural gas conversion company, a microfinance institution, land conservation, and a microinsurance provider highlight the various effective practices and lessons that investors have discovered when working with investees and co-investors to align capital structures, buyers, and business models to ensure continued impact post-exit.

This report provides inspiration for ambitious investors seeking the best possible results of their investments. The findings and examples can inform those looking to improve their practice by embedding and preserving social and environmental impact that extends far beyond an investment.

# Introduction

## Motivation for this study

The impact investing field has grown in size and sophistication over the past decade, and investors' portfolios have matured along with it. This maturation has resulted in greater emphasis on exits—particularly from private equity investments, which make up a large proportion of the impact investing landscape.<sup>1</sup> Since impact investors by definition seek to generate social or environmental impact alongside financial return, they tend to also be interested in the durability of that impact after they liquidate an investment. Indeed, most respondents to the GIIN's *2016 Annual Impact Investor Survey* indicated a belief that impact investors have a responsibility to try to ensure the continuity of impact after they exit an investment.<sup>2</sup>

Thoughtful consideration of the long-term, non-financial outcomes of investments raises several questions. Through what mechanisms can investors affect these outcomes? By what means, if at all, can execution of an exit manifest an investor's intent to generate positive impact? What are the impact-related implications of various aspects of exits, such as holding periods, buyer selection, or valuation? Can investments be structured in ways that increase the likelihood of successfully preserving impact through the exit? Lastly, what risks are involved in exiting without considering these factors?

The existing, limited literature on these and related questions focuses primarily on exits from microfinance investments and on mission drift from the perspectives of company founders. The GIIN's 2015 and 2016 Annual Impact Investor Surveys and the 2015 Wharton *Great Expectations* study each asked survey questions related to responsible exits, and the European Venture Philanthropy Association published a guide to impactful exits in 2014. In the same year, the Consultative Group to Assist the Poor (CGAP) and the Center for Financial Inclusion (CFI) published a paper on responsible exits in the microfinance industry that outlined the 'when,' 'how,' 'how much,' and 'to whom' of microfinance exits, focusing on development finance institutions (DFIs) as limited partners (LPs). (A full list of references is included in [Appendix 2](#), while [Appendix 3](#) summarizes key pieces of relevant literature.)

Expanding the scope beyond microfinance and venture philanthropy, this study draws on the experiences of impact investors, advisors, and social entrepreneurs to shed further light on these questions. The Research Team conducted 33 interviews with investors (both direct and those investing through funds), advisors, and social entrepreneurs from varying geographies and sectors to explore approaches to responsible exits in transactions using private equity, debt, mezzanine, real assets, and alternative structures. ([Appendix 1](#) provides a list of interviewees.)

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1 Of respondents to the GIIN's 2017 Annual Impact Investor Survey, 76% have at least some allocation to private equity, an asset class which represents 19% of assets under management in the total surveyed sample. Abhilash Mudaliar, Hannah Schiff, Rachel Bass, and Hannah Dithrich, 2017 *Annual Impact Investor Survey* (New York: The Global Impact Investing Network, 2017), 25, <https://thegiin.org/knowledge/publication/annualsurvey2017>.

2 According to the survey, 53% believe impact investors have a responsibility to try to ensure impact continuity for all types of investments and a further 29% believe they have such a responsibility for some types of investments. Abhilash Mudaliar, Hannah Schiff, and Rachel Bass, 2016 Annual Impact Investor Survey (New York: The Global Impact Investing Network, 2016), 44, <https://thegiin.org/knowledge/publication/annualsurvey2016>.

## Defining ‘exits’

In private equity, investors typically exit by selling all or part of their share of a company to another party—whether to another financial investor, through an initial public offering (IPO), to another company (sometimes called a ‘strategic’ buyer), or to the company’s own management. More broadly, however, exits include liquidity events that can occur across various asset classes (see table below). For example, investors in real assets sell land or other property rather than shares in a company. Those using equity-like debt with built-in repayment features would consider their investment ‘fully exited’ when fully repaid (or partially exited upon partial repayment). This report, while focusing mostly on traditional private equity exits, also considers other asset classes and structures when relevant.

**TABLE 1. EXIT TYPES BY INSTRUMENT**

INSTRUMENT	DESCRIPTION	TYPES OF EXITS
Private equity or venture capital	Investor owns shares of a company.	Investor sells all or some of owned shares: <ul style="list-style-type: none"><li>■ to another investor (“follow-on buyer” or “financial buyer”);</li><li>■ to another company (“acquirer” or “strategic buyer”);</li><li>■ to the founders or management team of the investee company (“management buyout”); or</li><li>■ to an investment bank which sells the shares publicly (initial public offering or IPO).</li></ul>
Private debt	Investor makes a loan to a company or project.	The loan is repaid in part or full (or, rarely, sold).
Real assets	An investor sells land or other property rather than shares in a company.	Investor sells land or other property.
Quasi-equity or convertible loan	Investor offers debt that has some equity-like features, such as flexible repayment options or the ability to convert to equity.	A loan is repaid or converted to equity; converted shares may later be sold.

*Note: The table includes the most common instruments used in impact investing and excludes public market instruments, which account for a small proportion of impact investing assets under management, according to the GIIN’s 2017 Annual Impact Investor Survey.*

## The need for responsible exits in impact investing

One of this study’s central questions is: ‘does it matter, in terms of impact, how you exit an impact investment?’ As this report argues, it usually does matter, because impact investors seek to create sustained, positive impact through their investments, even after exit. Concern for the business after exit differentiates impact investors from investors without impact intent, whose primary concern

is to maximize financial returns for their shareholders and who are otherwise agnostic about what later happens to the exited business. Of course, impact investors care about *both* financial return to shareholders and the business' long-term success; exits may be more complicated when these two objectives are not clearly in line and some prioritizing is required (see the section on “Achieving financial return objectives and impact” on [page 17](#)).

It is useful to look at the potential risks of *not* exiting responsibly. Even for investments where the impact is thought to be ‘baked in’ or occurring as a natural by-product of a given business model, there are risks of shifts in that business model that can be mitigated by a thoughtful exit plan. The risks of not exiting responsibly vary with the investment’s impact strategy or business model. The rest of this section broadly categorizes these strategies and accompanying risks.

Positive social impact often results from a business model designed to serve a specific target market, such as low-income individuals. Cases where positive impact derives from providing products or services to a certain population have various risks related to changes in business model, most obviously changes in pricing or target segment to serve higher-income or less-disadvantaged populations. At the extreme, a competitor could acquire the business to shutter it and suppress competition. To mitigate this risk, investors seek to ensure that a business model can remain largely unchanged while expanding to serve more customers in the target segment. For example, LeapFrog Investments partners with portfolio companies that provide affordable financial services and healthcare for low-income consumers in emerging markets. Impact can best be furthered, LeapFrog believes, by dramatically scaling up these businesses, thereby extending access to critical products for more customers ([see case study, page 28](#)).

Cases in which impact primarily derives from operations—for example, hiring practices, employee benefits, sustainable production, or environmental safeguards—have the risk that new owners might place less emphasis on these standards. For example, Lok Capital, a venture fund focused on inclusive growth, invested in a business process outsourcing company designed to provide training and employment opportunities in rural communities, helping retain talent in these areas by reducing the need to relocate for jobs. The best way to ensure impact continuity is to scale the business while maintaining its core model of providing employment in rural areas. When exiting investments, impact investors seek buyers whose vision for scaling the company is aligned with their own.

Businesses that rely on cross-subsidy models may especially face risks derived from tradeoffs between financial success and impact. In such models, the same product is sold to different market segments at different prices. Sales from high-income customers help make the product affordable for low-income customers. Bidders with plans to focus more on the high-margin customers may make more attractive financial offers; however, selling to those bidders may lead to diminished impact for the target populations of low-income customers.

Land or water conservation strategies, including sustainable land management, have risks related to shifting the use of the land, either to develop it or to follow less sustainable, possibly environmentally harmful practices. Affordable housing investments have the risk that follow-on owners might raise rents or stop providing a supportive environment to residents. If follow-on investors of assets benefiting from regulations, such as conservation easements or low-income housing tax credits, fail to abide by these regulations, the assets could be recaptured and turned

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 In a ‘**responsible exit**,’ investors seek to mitigate risks to an investment’s impact after exit.

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over for another use. Many real assets investors consider similar questions to those asked when vetting potential buyers of companies: what is the follow-on buyer's intended use for the asset? Does their long-term vision further or hinder the asset's impact? The [case study on page 25](#) shows how Beartooth Capital, which acquires land for conservation and restoration, chose a conservation-oriented buyer for a property in Montana.

In any investment, there is a risk of failure to bring the best or most appropriate resources (including financial, human, and network resources) to help the business grow and enhance its impact, operations, or product/service delivery. Investors interested in positive impact are necessarily interested in the long-term success of a business that they believe creates positive impact.

## Approaches to responsible exits throughout the investment lifecycle

This study concludes that there is no single consensus approach to ensuring responsible exits; rather, impact investors use a combination of one or more of the mechanisms outlined, depending on their investment strategy, theory of change, and role in the investment value chain. The 2014 study [The Art of the Responsible Exit in Microfinance Equity Sales](#), released by the CGAP and the CFI, similarly concluded that there is no single approach to responsible exits, as they depend on various themes that “affect the options that investors are likely to face: market context and stage of development; share of ownership being sold; and the MFI’s [microfinance institution’s] ownership structure, governance arrangements, and place in its life cycle.”<sup>3</sup> The report recommended four main considerations for investors, summarized in the text box below and echoed in the approaches described in the following section by the stage of the investment life cycle at which each is most relevant.



Four main considerations for responsible exits, according to [The Art of the Responsible Exit in Microfinance Equity Sales](#):<sup>4</sup>

1. **When:** Discuss desired timing with co-investors and management.
2. **To whom:** Assess the buyer's intention, commitment to the mission, type of capital and expertise.
3. **How:** Consider mechanisms to legally enshrine the mission.
4. **How much:** Screen buyers first on nonfinancial aspects of the bid, and then on financials.

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3 Daniel Rozas, Deborah Drake, Estelle Lahaye, Katharine McKee, and Danielle Piskadlo, *The Art of the Responsible Exit in Microfinance Equity Sales*, Access to Finance Forum, Report No. 9 (Washington, DC: Consultative Group to Assist the Poor, April 2014), 2, <http://www.cgap.org/sites/default/files/Forum-Art-of-the-Responsible-Exit-April-2014.pdf>.

4 Rozas et al., *Art of the Responsible Exit*, 2.

## 1. PRE-INVESTMENT

### IDENTIFYING BUSINESSES WITH IMPACT INTEGRAL TO THEIR BUSINESS MODELS

The most common approach to preventing mission drift among respondents to the GIIN's 2016 *Annual Impact Investor Survey* was to “only invest in companies/projects where the mission is naturally embedded in their work,” echoing the findings of the Wharton Social Impact Initiative's *Great Expectations* report, which surveyed impact investing funds and found that they “virtually always report that the mission persists in companies that are sold or acquired, even though a lower percentage report having statements in the realization agreements.”<sup>5</sup> The Wharton researchers suggested that this stems from the pursuit of companies “that have social impact ‘embedded’ as a core business element.”<sup>6</sup> For example, Elevar Equity only invests in companies for which impact is core to the business model, helping to mitigate potential tradeoffs between impact and financial success at exit. Describing Elevar's approach to responsible exits, co-founder Sandeep Farias noted, “We make investments where if you achieve financial success, you automatically achieve impact. For example, if we invest in libraries for children, the two most important metrics are number of kids reading and number of books per child. These metrics indicate both commercial and impact success.”

### UNDERSTANDING COMPANY GROWTH TRAJECTORIES

When selecting investments, many—though notably not all—impact investors consider companies' plans for growth and future funding needs, and how these may influence exit paths. As with any exit, likely paths also depend on factors such as the stage of the business at the time of investment, the projected growth of the company, and the strategic value or competition larger companies might perceive from the company. As Annie Roberts, co-founder of Nairobi-based consulting firm Open Capital Advisors, pointed out, “Most impact investors consider their exit options during diligence—for each deal, options are based on the life cycle and time frame in which they expect to exit. In practice, if the planned exit for a given business is to a large strategic [buyer] that might not share the same impact motives, the investor takes this into account when deciding whether to make the investment in the first place.”

Sandeep Farias of Elevar Equity explained, “Early on and through the journey, we have conversations with the entrepreneur around alignment, their vision for the company, and how they are thinking about long-term opportunities.” These in-depth conversations enable nuanced understanding of likely growth trajectories and help investors remain flexible and open to multiple outcomes.

Geography and sector of investment also influence likely exit scenarios, since some segments have thin secondary markets that may limit exit options. Many emerging markets have fewer viable

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5 Jacob Gray, Nick Ashburn, Harry Douglas, and Jessica Jeffers, *Great Expectations: Mission Preservation and Financial Performance in Impact Investing* (Philadelphia: Wharton Social Impact Initiative, 2015), 22, <https://socialimpact.wharton.upenn.edu/wp-content/uploads/2016/09/Great-Expectations-Mission-Preservation-and-Financial-Performance-in-Impact-Investing.pdf>.

6 Gray et al., *Great Expectations*, 22.

downstream investment opportunities, and stock exchanges are nascent—if they exist. In addition, given their missions to address market failures, many impact investee companies work in sectors with limited merger and acquisition activity.<sup>7</sup> Compounding the relative difficulty of exiting, many impact investors desire to find an aligned buyer—one who at least shares their vision for scaling the company and at best conforms to a more detailed set of criteria, makes some commitments to furthering the impact of the investment, or both. Understanding these considerations before investing can help set and manage realistic exit expectations while maintaining impact.

## INVESTING IN MISSION-DRIVEN FOUNDERS AND MANAGERS

Impact investors often invest in companies with founders who are passionate about creating social impact. Many interviewees noted that a strongly aligned founder will be more likely to make decisions that uphold and further their impact objectives during their growth plans and capital raising. Several interviewees expressed that both selecting the right entrepreneurs and leadership team and then maintaining company management after exit jointly help to ensure impact continuity.

## 2. AT THE TIME OF INVESTMENT

### SELECTING AN INSTRUMENT AND STRUCTURING THE INVESTMENT

The investment instrument informs expected financial return, holding periods, and company ownership, which in turn affect approaches to responsible exits. Considerations affecting the choices among private equity, private debt, and alternative structures are described below.

#### *Private equity*

Private equity investments, especially those made by funds, often have pressure to exit within a defined timeframe. A 10-year fund might typically hold an investment for just three to five years. This model has a handful of drawbacks for impact investing. First, impact investments often require patient capital for various reasons, including innovative business models and difficult market contexts. Further, more flexible timelines can help impact investors find an appropriate, mission-aligned buyer (as described in the “Selecting aligned buyers” section on [page 13](#)), which may take longer than is typical for conventional private equity or venture capital funds. In addition, some companies can benefit from a longer investment period with the same investors, who may continue to add value and help grow the business through expertise and resources. Some exit pressure, on the other hand, may help enforce disciplined and careful management of a company toward growth and improved operations.

Businesses’ growth trajectories present a related consideration. Venture capital funds, in particular, expect some investments to be runaway successes with explosive growth, while others will likely fail; with successes and failures in the right proportion, funds expect to generate risk-adjusted returns overall. For two reasons, such a strategy may not suit impact investing. First, many businesses

“ When I’m pitching, I look for investors who are on board with the vision and excited about the challenges we’re facing and helping us figure them out. That often comes from their investment priorities and impact priorities. We look for really solid alignment. ”

Emily Stone,  
*Uncommon Cacao*

“ While direct private equity can be used to finance sustainable solutions to intractable problems, I am not certain it can solve those problems within the existing limitations of private equity funds. ”

Dominique Slavin,  
*Treehouse Investments*

<sup>7</sup> Andrea Armeni and Miguel Ferreyra de Bone, *Innovations in Financing Structures for Impact Enterprises: Focus on Latin America* (Washington, DC: Multilateral Investment Fund, 2017), 5, <https://www.fomin.org/en-us/Home/Knowledge/idPublication/194751.aspx>.

generating impact—particularly in disadvantaged communities—are better served by building slowly and steadily than by following a ‘hockey-stick’ growth curve. Second, allowing a business to fail outright can potentially have material negative social impact, if ending operations will lead to loss of jobs or cessation of critical basic services. Imagine the effect, for example, if a health clinic in a remote area were to suddenly disappear. Rather than writing off the investment, it might be more responsible to help the business stabilize and reach sustainability over the long term, even if that means a longer investment period or more modest returns. Thus, private equity and venture capital approaches with longer or more flexible terms may better facilitate responsible exits.

### **Debt**

Since debt investments traditionally involve fixed or somewhat rigid repayment timelines, more flexible investment timelines, as with equity investments, can help accommodate responsible exits. Otherwise, exits from debt investments usually involve a company repaying a loan, so there is no need for an investor to find a buyer, aligned or otherwise. Nor do debt investments depend on rapid growth for solid financial returns, as might private equity or venture capital investments, a feature that can mitigate some risk that a company sacrifices impact for growth. Debt investments also avoid equity dilution; maintaining founder ownership can help ensure the continuity of impactful practices.

### **Alternative structures**

Some investors have found value in alternative structures to mitigate the risk of mission drift. A recent report by the Transform Finance Network, the Multilateral Investment Fund, and the Rockefeller Foundation detailed various structures, particularly suited for early-stage impact enterprise financing, that “hinge on a return to investors that is not contingent on a hypothetical future liquidity event, such as a merger or an acquisition.” Such structures include both debt and equity instruments in which repayment is tied to revenue to mitigate risk, increase flexibility, and include potential upside benefits. According to the report, debt-based mechanisms are well-suited for investments with “some visibility into when the company will be profitable and a somewhat predictable return,” whereas equity-like mechanisms are more appropriate for early-stage investments with unpredictable returns.<sup>8</sup>

Oliver Karius, Partner at LGT Impact, noted that structures with built-in repayment can preserve managers’ control over the business: “For instance, if you choose a revenue participation model or self-liquidating instrument, there’s a stronger chance that the original mission can be preserved.” In the [case study on Adobe Capital’s investment in Natgas \(page 19\)](#), a convertible debt investment provided flexibility on exit timing and ownership. Of course, for companies requiring large investors with ‘deep pockets’ to help them scale, a planned repayment or buyback may not be the best path. In the Natgas case, convertible debt was paired with preferred equity shares, which were eventually sold to a larger private equity firm to raise growth capital.

“ The rate of growth expected by traditional venture capital is just not consistent with what’s possible, or even desirable, for a lot of social enterprises. ”

Andrea Armeni,  
*Transform Finance*

8 Armeni and Ferreyra de Bone, *Innovations in Financing Structures for Impact Enterprises*, 6.

## Degree of ownership

Control over many choices related to exit depends on the investors' degree of ownership and decision-making power in a company. Some interviewees noted that considerations about responsible exits are more important when selling a majority stake than when selling a minority stake. When selling a minority stake, it is likely that the existing shareholders will effectively maintain the trajectory of the company. Thus, they will likely maintain the impact of the company, particularly if they were mission-aligned investors. To plan for this, many impact investors seek to invest alongside aligned co-investors, evaluating co-investors with similar criteria as those used to determine alignment with a company's mission and vision. (See more in the "Aligning with co-investors" section below.)

Nonetheless, even when purchasing minority ownership—sometimes with the intent to enable entrepreneurs and promoters to maintain control—many impact investors can develop a close relationship with management. Impact investors often take a board seat and work closely with entrepreneurs to add value through advice or connections. Having developed this relationship over the course of the investment, investors may have a measure of influence over exit strategy, even if their investor agreement does not legally enshrine control.

While direct investors tend to have greater control over exit decisions than do indirect investors, interviewed fund investors (limited partners or LPs) described using one or more of three different mechanisms for ensuring responsible exits: (1) fund selection, (2) relationships with managers, and (3) co-investing. First, impact-oriented LPs tend to evaluate a fund manager's approach to exits as part of their diligence process (see quote at right). Second, LPs can influence exits through their ongoing relationships with fund managers and informal influence over decisions made by fund general partners. Third, some fund investors co-invest alongside their fund managers, which enables them to leverage the diligence their fund managers already perform and ensures they are aligned on exit.

## ALIGNING WITH CO-INVESTORS

Since growing businesses tend to raise capital from multiple investors in multiple rounds, incoming investors often join one or more existing or incoming co-investors. Some interviewees noted that the other investors in their deals often share similar objectives to create positive impact. Alignment with co-investors on key aspects of the business model and strategy helps ensure that all parties advocate for decisions that protect impact. Critical aspects to achieve impact on which co-investors should align include target market segments, pricing strategies, planned geographic growth, and ESG practices. The [case study of Adobe Capital's investment in Natgas \(page 19\)](#) describes how aligned co-investors helped facilitate a responsible exit. First, all investors aligned on the decision to seek a new investor to help scale the company. Further, to consolidate the shareholder structure, the co-investors purchased Adobe's stake—facilitating a responsible exit since Adobe knew the buyers had been aligned with Natgas' mission from the beginning.

## INCORPORATING IMPACT INTO LEGAL STRUCTURES AND DOCUMENTS

Third-party certifications and legal structures regarding a company's social or environmental mission can clarify and formalize impactful practices, helping to align company management and investors.

“What we do is select private equity managers that are 'likeminded,' which means they are aligned with FMO in terms of mandate, strategy, and ESG [environmental, social, and governance]. If a fund manager does not exit responsibly, it could seriously damage their reputation, which will ultimately impact their ability to source deals and raise future funds.”

Annette Berendsen,  
FMO

For example, companies might pursue B Corporation certification to indicate that they meet high social and environmental standards on factors such as corporate governance, environmental impact, and community involvement. Through the B Corporation certification, companies signal their mission-aligned priorities to potential investors, attracting an aligned investor base.

Legal structures and shareholder provisions can also help ensure that impactful practices continue while a company grows. As Grassroots Capital's concept note "Hardwiring' Social Mission in MFIs," explains, "structural approaches to 'hardwire' social mission" in shareholder agreements help give founders and investors "confidence that the mission of the company will be preserved in the face of investor turnover or dilution."<sup>9</sup>

In over 30 U.S. states, companies can become a Benefit Corporation, a distinct legal structure that requires company management and boards to consider the interests of stakeholders beyond their shareholders—such as employees, the community, or the environment. The structure also protects against shareholder lawsuits when companies act in the interests of these other stakeholders. Formalizing mission-related practices through legal structures helps avoid confusion about priorities during strategic decisions, ensuring impact continues through changes in company ownership or management. Plum Organics was one of the first companies to become a Benefit Corporation in Delaware once the state legalized Benefit Corporation status in 2013. In this unique example, Plum Organics was in the process of being acquired by the Campbell Soup Company in the first acquisition of a Benefit Corporation by a public company. Campbell's indicated that they saw Plum's Benefit Corporation status as an asset. Plum's co-founder Neil Grimmer has commented on the value of formalizing the company's mission, stating, "When these ideas become inscribed in your corporate bylaws, it becomes the compass of the company. Now more than ever that's part of our charter."<sup>10</sup>

Shareholder agreements can also help companies articulate and preserve their missions by including provisions around impact, such as reaching impact targets, protecting clients, or reporting on impact performance. A potential disincentive, however, is the risk that these provisions become too restrictive; management and investors may wish to avoid adding too much detail, since changing provisions might become a laborious process involving unanimous shareholder approval (see section on "Contractual agreements at exit" on [page 15](#)). Shareholder agreements can also enshrine specific responsibilities to certain shareholders or boards of directors.<sup>11</sup> In one such example, Ben & Jerry's, during its merger with Unilever, established a board specifically mandated to preserve the company's mission (for more, see the case example on [page 16](#)).

Dual share structures can also protect impact across a company's lifecycle. Differential voting rights or anti-dilution provisions can help "preserve control in the hands of founding shareholders who, it is argued, can safeguard the essential culture of the company, as well as enable managers to take a longer term perspective on building value," Grassroots Capital explains in their concept note.<sup>12</sup> Different share classes, such as non-voting or golden shares, can help prevent un-aligned

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9 Grassroots Capital Management, "Hardwiring' Social Mission in MFIs" (Concept note, Grassroots Capital Management, 2014), 1–2, [https://www.grassrootscap.com/wp-content/uploads/2014/02/Hardwire\\_Jan2014.pdf](https://www.grassrootscap.com/wp-content/uploads/2014/02/Hardwire_Jan2014.pdf).

10 Ariel Schwartz, "Inside Plum Organics, the First Benefit Corporation Owned by a Public Company," *Fast Company*, January 22, 2014, <https://www.fastcompany.com/3024991/inside-plum-organics-the-first-benefit-corporation-owned-by-a-public-co>.

11 The Impact Terms Project provides sample legal language for delegating mission oversight to a committee or director: <https://impactterms.org/2016/05/impact-committee-or-director/>.

12 Grassroots Capital Management, "Hardwiring Social Mission," 1.

shareholders from pushing through decisions that could threaten impact. Ensuring founder control can also help managers avoid ‘short-termism’ to focus on long-term company well-being. On the other hand, such consistent control might hinder management’s flexibility to adapt in cases of underperformance.

### 3. DURING INVESTMENT MANAGEMENT

#### ENCOURAGING IMPACTFUL PROCESSES AND POLICIES AT THE INVESTEE ORGANIZATION

One strategy to preserve mission involves embedding impact within an investee organization’s processes, policies, and culture. According to Peter van der Werf, Senior Engagement Specialist at Robeco, which invests in listed assets, “Whenever feasible, we work together with the company to improve their sustainability practices and thereby leave a better company. When we decide to sell the position, our active ownership activities have improved the company along the way.” Robeco sets specific objectives for improved practices at its investee companies; for example, a meatpacking company might be asked to publish an animal welfare policy, commit to reduce animal travel time, and curtail the use of antibiotics. The case study on LeapFrog’s investment into the Ghanaian life insurer Express Life offers another example of instilling positive processes and policies (see [case study, page 28](#)).

### 4. AT THE TIME OF EXIT

#### EXITING AT THE RIGHT TIME

Exit timing is an important factor in any investor’s success. Many interviewees described timing considerations common to any private equity investment, including phase of the fund’s life, investor liquidity needs, availability of attractive exit options, external market forces, and changes in the valuation of the portfolio company. Many impact investors assess progress towards impact and financial goals throughout the life of the investment. Like the achievement of financial or growth objectives, the achievement of impact objectives may signal that the investment has completed its intended goals; if so, it may be time to exit.

 The European Venture Philanthropy Association’s report, ***A Practical Guide to Planning and Executing Impactful Exits***,<sup>13</sup> emphasizes three main considerations to determine an investee’s exit readiness: (1) social impact achieved, (2) financial sustainability, and (3) organizational resilience. The goal, the report notes, is to leave the organization with “a stronger business model and organizational structure,” one “that is capable of attracting and managing the resources necessary to pursue its social goal(s) in the long term.”

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<sup>13</sup> Priscilla Boiardi and Lisa Hehenberger, *A Practical Guide to Planning and Executing an Impactful Exit* (Brussels: European Venture Philanthropy Association, November 2014), 8, <https://evpa.eu.com/knowledge-centre/publications/planning-and-executing-an-impactful-exit-a-practical-guide>.

Most interviewees also said they consider what a company needs to achieve long-term success. This involves answering several questions. What does the company need right now? Where is it on its path to growth? What challenges does it face? What type of capital does it need to continue growing? If a company needs capital and resources beyond what the current investor can provide, the current investment may have fulfilled its role, and it may be time to exit. In planning to exit, most interviewees said they attempt to secure the right investor to add value and help the company scale, preferring to exit at a time that creates more long-term impact rather than at the best time from a purely financial perspective. However, searching for an aligned buyer can take time; some interviewees described requiring greater flexibility in time horizons to exit either earlier or later than expected, depending on the needs of the company and the exit opportunities that arise. The **Beartooth Capital case study** offers a detailed example of an investment which required such flexibility ([page 25](#)). The “Selecting an instrument and structuring the investment” section ([page 8](#)) also offers more detail on this topic.

## MANAGEMENT CONTINUITY

Several interviewees mentioned a desire for exit pathways in which the current company management remains at the helm, an approach which clearly helps preserve mission. Management continuity is especially important for exits through initial public offerings, since the multitude of new shareholders will each have different profiles and little individual influence over the company’s direction. Management continuity may also play a central role in strategic sales, as the smaller company is merged into an existing management structure. On the other end of the spectrum, an exit through management buyout offers the best assurance of continuity but does not provide the benefits of added capital, connections, or resources that an outside investor or strategic buyer might offer. Anti-dilution shareholder agreements can also help ensure some continuity of management across changes in company ownership.

## SELECTING ALIGNED BUYERS

When it comes time to exit their investments, many investors attempt to select ‘aligned’ buyers who can help ensure long-term impact. But it can be challenging to define an ‘aligned’ buyer or estimate such an alignment’s duration and durability. In the case of microfinance, as Grassroots Capital’s 2014 concept note explained, investors often label themselves “social” investors. Though the label signals their social mission, “the ubiquity and imprecision of the ‘social’ label . . . masks very wide differences in theories of change, and performance expectations or requirements. These differences—which investors themselves may not be fully aware of at the outset—will eventually express themselves, potentially upending an apparent consensus over strategy and priorities.”<sup>14</sup>

Interviewees noted that aligned buyers most often share with them a similar vision for a company and can provide the resources needed to help it achieve that vision. Sandeep Farias of Elevar Equity explained that exits are “about finding an aligned buyer who is consistent with the overall trajectory of the company. Therefore, we do not face the challenges around tradeoffs. Because the shared value is core, it’s embedded, [it’s in] customer value. Every investor coming to the table understands customer value. So long as they understand that, there is alignment and entrepreneurs recognize that they are the best investor for the company.”

“ Ideally, you find a party who wants to buy the stake and also sees commercial sense in sticking to the mission. ”

Caspar Sprokel,  
Triodos

<sup>14</sup> Grassroots Capital Management, “Hardwiring Social Mission,” 4.

Investors ensure that buyers are mission-aligned through ‘gut check’ conversations, by knowing the buyer well (often having worked closely with them before), or through a set of more detailed criteria, described below.

**Positive track record of regulatory compliance and ESG standards:** Many investors at least ensure that a potential buyer complies with relevant regulations and has a good reputation. Several interviewees noted conducting the same ‘know-your-customer’ (KYC) diligence on potential buyers as on potential investments. In the words of David Osborne, Director at CDC Group plc, “We wouldn’t sell to anyone we wouldn’t invest in.” Such diligence typically includes ensuring that an organization is not blacklisted, under investigation, or otherwise disreputable. Beyond these routine checks, investors seek to understand other aspects of an organization’s track record, such as their history of serving target populations and how they have handled previous acquisitions.

Especially among DFIs, a track record of applying high ESG standards is another common desirable feature of acquirers, according to interviewees. David Osborne of the British DFI CDC explained, “We look for buyers who fundamentally share our values in terms of applying the highest quality of environmental and social standards, applying the highest quality of governance, applying the highest quality of business integrity, and are committed to maintaining the standards that we’ve tried to get our invested companies to live up to while we’ve been involved with them.”

**Experience in the industry:** When considering strategic and financial buyers, many impact investors look for acquirers with significant experience in the relevant industry. As Enclude CEO Laurie Spengler noted in a 2014 blog post, “Typical sale transactions (non-impact) tend to focus solely on the objectives of the selling shareholder(s). In impact transactions, we have learned that focused attention must be given to the underlying investee institution—what type of investor does the investee need at this moment in time to be able to deliver on its business objectives?”<sup>15</sup> Especially for investors whose exit objectives center on helping a portfolio company further its growth and scale up its operations, securing a buyer with expertise and resources increases the likelihood the company can achieve these goals. Buyers with industry expertise will also be more likely to understand and align with the company’s business model and strategy, another common criterion for buyers, as noted above.

For example, in the context of investments in U.S. affordable housing, exiting investors have strong incentives to ensure that buyers have the industry experience to manage the properties well. Many affordable housing managers work to provide a safe, healthy, and beneficial environment for low-income tenants while keeping rents affordable. A new property owner should have the expertise needed to maintain this environment and continue any services provided to residents. Furthermore, some affordable housing properties are subject to regulations, such as low-income housing tax credits, which require that a percentage of tenants fall below a certain income level. If an investor sells a property under such restrictions and the buyer falls out of compliance, perhaps by renting to tenants earning more on average than the income threshold, the U.S. Internal Revenue Service could potentially recapture tax credits allocated to the seller in previous years. Considering both impact continuity and financial risk, affordable housing investors look for buyers that are equipped to properly manage the properties.

“ On the social impact side, we ask the very simple questions of: ‘Who are you exiting to? Who is buying this property and what is the DNA and makeup and mission of that buyer? What is the business plan? Is the mission of the buyer tied to affordable housing? Or is the plan to over-improve those units such that they can no longer be affordable?’ ”

**Rekha Unnithan,**  
*TIAA Investments*

<sup>15</sup> Laurie Spengler, “Responsible Exits,” Enclude (blog), March 31, 2014, <http://encludesolutions.com/responsible-exits/>.

**Rationale for purchase:** Exiting impact investors also consider whether the new owner has a logical business reason to integrate and expand the acquisition target—or if they will more likely shrink and consolidate it. For example, Sea Change Fund, which invested in wholesale seafood companies to encourage them to purchase sustainably caught fish,<sup>16</sup> sold one company to a strategic investor that planned to use the acquisition to expand into the sustainable fish market and capture a price premium on those products. Sea Change passed up an earlier exit opportunity because of the perceived risk that the potential buyer, who did not appear to understand the value of the sustainability practices Sea Change helped implement, would discontinue them.

## CONTRACTUAL AGREEMENTS AT EXIT

Interviewees also identified some less-effective practices, such as putting provisions in contracts requiring new owners to preserve impact. With few exceptions, most investors find these arrangements to lack ‘teeth’; exiting investors are very unlikely to pursue lawsuits to enforce them. Nor do most interviewees regularly investigate whether their previous investments continue to be impactful. Further, contractual provisions can make assets less attractive by adding complexity to the deal, potentially reducing exit options.

Interviewees did note three instances in which contractual arrangements are effective, all of which are enforced by governments and thus avoid the possible need for enforcing litigation between two private parties. First, in an easement, a property owner sells the rights to develop land to the government, which permanently protects the land, even when it changes ownership. Second, regulatory agreements concerning affordable housing properties, such as low-income housing tax credits, place restrictions on rent increases to maintain affordability. Third, foundations making program-related investments (PRIs) sometimes benefit from preferred tax status if they include minimum charitability thresholds in their investment agreements. Such agreements ensure that a portfolio company continues to operate in a way that serves their mission, sometimes including the provision that if the charitability threshold is no longer met, the investee company must buy back the foundation’s investment to return their capital.

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<sup>16</sup> The fund has since closed and returned capital.

## Case Example: Mission Preservation at Ben & Jerry's

Unilever's acquisition of Ben & Jerry's has been the subject of several articles and case studies concerning mission preservation through the acquisition process.<sup>17</sup> Since its founding in 1978, Ben & Jerry's has developed an image of social and environmental progressivism and activism. In 2000, Unilever acquired Ben & Jerry's for USD 326 million. At the time, many observers saw conflict between Ben & Jerry's progressive brand and that of a major consumer goods conglomerate with no explicit social mission (though Unilever has since become a leader in sustainable and inclusive business practices).

The acquisition raised concerns among Ben & Jerry's fans, as well as among its founders and owners, Ben Cohen and Jerry Greenfield, that the company's mission to "make the world a better place" would be sacrificed for profits and shareholder value. Responding to these concerns, Unilever established a separate, independent board of directors to oversee Ben & Jerry's and develop a strategy to preserve the company's image and mission. This gave the company more power than usual for a Unilever subsidiary, including the ability to allocate 7.5% of its annual profits to the Ben & Jerry's Foundation.

The relationship between Ben & Jerry's and Unilever has seen both challenges and successes. Cohen and Greenfield wrestled with the tension between the possible damage to the company's mission and its duty to shareholders to accept Unilever's attractive financial offer. Shortly after the deal was finalized, a Ben & Jerry's manufacturing and distribution facility was shut down, forcing layoffs at a company that had until then rarely fired an employee. After that rocky start, Ben & Jerry's independent board of directors has utilized its authority to set social impact objectives and mitigate interference from Unilever, which has itself since adopted more socially and environmentally friendly business practices. Because of the acquisition, Ben & Jerry's has been able to leverage Unilever's global scale to reach more customers, while standing behind its social and environmental values.

### After exit

Following up with investees after they exit is generally not a very effective way of ensuring impact continuity, according to most interviewees. Among the 169 respondents to the GIIN's report *The State of Impact Measurement and Management Practice*,<sup>18</sup> only 11% indicated collecting impact-related data on investees after exit. Some interviewees for this study noted keeping in touch with past investees, particularly those with which they have close relationships, but they no longer have the formal information rights or influence afforded an investor. One uncommon but interesting approach to continued involvement is to assign, at exit, a measure of ownership or control—for example, a golden share with special voting rights—to a foundation related to the investor. An investor might also exit by selling shares to a foundation that issues participation certificates, giving certificate holders financial exposure while maintaining the foundation's rights to influence company by-laws and key decisions.

17 David Gelles, "How the Social Mission of Ben and Jerry's Survived Being Gobbled Up," *New York Times*, August 21, 2015, <https://www.nytimes.com/2015/08/23/business/how-ben-jerrys-social-mission-survived-being-gobbled-up.html>.

18 Abhilash Mudaliar, Aliana Pineiro, Rachel Bass, and Hannah Dithrich, *The State of Impact Measurement and Management Practice* (New York: The Global Impact Investing Network, 2017), 44, <https://thegiin.org/knowledge/publication/imm-survey>.

# Achieving financial return objectives and impact

When asked whether they face tension between optimizing financial and impact outcomes at exit, about half of interviewees indicated that they never do, with the other half indicating that they sometimes do. Many of those who reported never facing tradeoffs explained that they choose investments in which positive impact naturally arises from the business model. In their view, as long as the business continues to operate and scale with no drastic changes to the business model, its impact will increase along with its value. Follow-on investors or acquirers will pay a price that reflects their understanding of the value of the company's scale and impact. Other interviewees indicated never facing tensions or tough choices at exit because they prioritize impact over financial returns throughout the investment process, including at exit.

One common approach of some impact investors involves a two-stage screening process for potential bidders. The seller first narrows the list of invited bidders to those meeting certain impact-related criteria. Having screened out any buyers that pose risks to impact continuity, the seller then evaluates bids financially. This enables sellers to achieve the best financial outcome from among those options that ensure a minimum level of mission preservation.<sup>19</sup>

When securing financial bids, investors also consider how price might affect the follow-on buyer's ability to ensure durable impact. Paying a relatively high price for an investment might negatively affect a buyer's management of that investment. They might be less able to invest further in the company, perhaps facing pressure to lower costs, raise prices, or shift to higher-margin customer segments. A more responsible exit might then entail accepting a lower financial offer that enables the buyer to maintain the business model without conflict.

The expected level and timeline of return can affect investees' ability to generate impact. For example, investments with higher return expectations (and shorter time horizons) may put pressure on companies to sacrifice impactful practices in order to grow quickly. Investors that cannot identify an aligned buyer with a bid meeting their target financial returns can either accept a lower return to accommodate their impact objectives or shift their time horizons to wait until they find the right buyer.

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<sup>19</sup> This filtering process is described further in Enclude CEO Laurie Spengler's 2014 blog post, "Responsible Exits."

# Conclusion

The central premise of impact investing requires that investors select and manage their assets to create benefits for communities and the environment. Having worked hard to help companies and projects generate positive impact, most impact investors would like some assurance that the created impact will continue and grow long after their role as an investor is complete. Investors take steps to responsibly exit their investments throughout the investment lifecycle, starting from the initial sourcing of investments. Investors' various approaches to help articulate strategic objectives and determine alignment between incoming investors' and investees' priorities are summarized as follows:

## 1. PRE-INVESTMENT

- Invest in organizations for which impact is inherent to their business models.
- Understand the investee's plans for growth and likely exit scenarios.
- Invest in mission-driven founders.

## 2. AT THE TIME OF INVESTMENT

- Co-invest with aligned investors.
- Hardwire impact through shareholder agreements or legal certifications.
- Structure investments to plan for responsible exits.

## 3. DURING THE INVESTMENT

- Embed impactful practices into company processes that will outlast changes in ownership.

## 4. AT THE TIME OF EXIT

- Exit at the right time to ensure the company has access to the resources it needs to scale.
- Maintain management in place.
- Select aligned buyers according to various criteria, such as their vision for scaling the company, track record, and experience in the sector.

Different investors use these approaches in different combinations. The present diversity of approaches notwithstanding, there is general consensus among investors that exits should benefit many stakeholders, including customers, employees, entrepreneurs, the environment, and investors alike. This calls for further, careful thinking in the field about exits to ensure they do so. Maintaining the centrality of impact throughout all stages of the investment process can help deliver on the promise of impact investing: to generate positive outcomes for society and the environment through the allocation and management of capital.

## CASE STUDY

# ADOBE CAPITAL'S EXIT FROM NATGAS

### Background on the investor

Adobe Capital, founded in 2012 and based in Mexico City, creates social and environmental impact by investing in impactful early- and growth-stage enterprises in Latin America. Adobe first examines potential investments to understand whether impact is centrally embedded in the company's business model before screening for potential financial return (the fund manager targets risk-adjusted, market-rate returns). Adobe's business model includes a close partnership with New Ventures, a business accelerator that provides technical assistance to early-stage Mexican enterprises creating positive social and environmental impact.

Adobe Capital raised its first fund, Adobe Mezzanine Fund I, in 2012 with USD 20 million from institutional investors, such as the Inter-American Investment Corporation, the German Development Bank (DEG), and Calvert Investments. Adobe works closely with its limited partners, often providing co-investment opportunities. Adobe Capital is GIIRS-rated and has so far made eight investments, all in companies with fewer than 50 employees, with less than USD 5 million in sales and in sectors such as education, housing, healthcare, sustainable consumer products, and alternative energy. Fund I began returning capital to investors in 2015 without write-offs or write-downs to date.

Adobe is now raising its second fund, Adobe Mezzanine Fund II, to deploy USD 40 million of quasi-equity financing. The fund will use tailored mezzanine financing structures with pre-defined exits and upside participation, combined with technical assistance from New Ventures. Because Adobe tailors its financing to best support early- and growth-stage entrepreneurs, the fund favors approaches such as royalty-based repayment structures that do not require sale of the company to achieve liquidity. Adobe believes that relieving the pressure to eventually sell the company helps avoid a scenario in which enterprises pursue unsustainable growth rates to attract follow-on investors, potentially challenging their social mission. This practice helps maintain founder control and continuity of impactful processes.

## Key Details

### Investor description

Fund manager

### Mission

To promote positive impact by supporting socially and environmentally impactful early- and growth-stage entrepreneurs in Mexico

### Sector

Alternative energy

### Geography

Mexico

### Instrument

Combination of a senior convertible loan and preferred equity

### Holding period

Two years

### Exit mechanism and scope

Full exit, with monthly payments of the convertible loan until full repayment followed by share sale to existing shareholders

Source: Adobe Capital



## Background on the investment

Natgas is an alternative energy company, founded in 2012 by Josue Hernandez, that converts public buses and taxicabs from regular gasoline to natural gas and operates a network of natural gas vehicle fueling stations. Vehicular natural gas is considered 40% less harmful to the environment than traditional gasoline, yet the fuel has seen limited use in Mexico's public transportation network due to a lack of infrastructure to support its use. Responding to this need, Natgas provides an integrated solution for clients that includes servicing stations, vehicle conversion shops, and securing financing support for vehicle conversions. The company's activities reduce carbon dioxide emissions and provide customers with fuel cost savings of more than 50%.

Seeing a fit with Adobe's mission to support alternative energy companies, DEG referred Natgas to the fund in 2013. Since the company was at a very early stage, Adobe first referred it to New Ventures' accelerator program. There, the company received technical assistance and a USD 0.4 million loan, launching operations with its first natural gas fueling station in the city of Queretaro, where it converted 200 taxicabs from traditional gasoline to natural gas.

Toward the end of the accelerator program, Natgas and Adobe Capital discussed a potential investment to fund the construction of five additional fueling stations and 2,200 vehicle conversions over five years. In 2014, alongside co-investment from Auria Ventures (a limited partner in Adobe Mezzanine Fund I) on an 80–20% pro-rata basis, Adobe invested a USD 0.5 million senior convertible loan and USD 0.3 million in equity, amounting to a 6% share.

Adobe's mezzanine financing matched the type of funding Natgas needed, since it expected its fueling stations to be profitable within three months of operations. Mezzanine capital can be an attractive financing alternative for companies already generating positive cash flows and seeking to avoid equity dilution. By structuring loan repayments as a percentage of revenues, companies can adapt their repayments to the often highly variable cash flows of small and medium-sized enterprises. The self-liquidating nature of its mezzanine convertible loans also allowed Adobe Capital to begin receiving loan repayments early in the life of its investment, mitigating potential loss and reducing the risk of its overall portfolio. As with many of its investments, in the case of financial underperformance, Adobe Capital had the right to convert the unpaid balance of a convertible loan into equity to participate in any future upside. Its preferred shares in Natgas provided Adobe with veto rights over several major categories of decisions, including those pertaining to staff compensation, cash reserves, and debt raises. Adobe also included a put option to sell its shares back to the original shareholders in Natgas' first equity raise.

As Natgas grew, it required additional capital to finance its expansion to neighboring states. Adobe continued to support this growth through three follow-on equity investments, reaching a total investment of USD 1.2 million from 2014 to 2016. Adobe also sought to play an active role in supporting Natgas, taking a seat on its board of directors and, through its relationship with DEG, helping Natgas to secure a technical assistance grant from DEG to strengthen its corporate governance practices. Adobe is a registered field partner of the microcredit lender Kiva, helping Natgas' customers to receive over USD 200 million in 0%-interest microloans from Kiva to finance vehicle conversions. Lastly, Adobe assisted Natgas to secure a GIIRS impact rating, which certified its positive social and environmental practices and impact.

## Exit objectives and considerations

By the time Natgas opened its fifth fueling station, two years into Adobe's investment, it began to attract the attention of international financial firms for a larger investment that would accelerate its growth to over 25 stations in four years. As Natgas entered this new period of growth, Adobe helped negotiate an investment from the private equity firm Northgate Capital, which had the resources and institutional capital needed to accelerate Natgas' growth. With Northgate's investment, Natgas' existing shareholders sought to consolidate the shareholder structure, so a group of them purchased Adobe's equity position, while Natgas repaid its outstanding debt at the contractual 2X multiple.

## Results and lessons learned

Adobe's investment in Natgas generated a 22% IRR in USD, along with measurable environmental and social impact. Natgas successfully built five stations and exceeded its vehicle conversion goal of 2,200 cars in five years, converting 2,500 cars in two years and reducing carbon dioxide emissions by 136 tons to date. Natural gas also saves drivers over 55% on fuel costs, increasing the share of their incomes available for other expenses.

The case also illustrates the potential benefits, for enterprises and investors alike, of creative financing models that provide an alternative to traditional private equity structures. Such approaches offering flexible repayment options can facilitate responsible exits by limiting the pressure to exit on a specific timeframe, which can limit buyer options, lead to unsustainable growth, and force equity dilution.

Source: Adobe Capital



## Key Details

### Investor description:

Private equity fund manager

### Mission

To promote inclusive growth for low-income/base-of-pyramid populations in India

### Sector

Microfinance

### Geography

India

### Instrument

Equity

### Holding period

Five years

### Exit mechanism and scope

Full exit through strategic sale

## CASE STUDY

# LOK CAPITAL'S EXIT FROM A MICROFINANCE COMPANY

## Background on the investor

Lok Capital (“Lok”) is a private equity fund manager, founded in 2004, that focuses on fostering financial and social inclusion in India. Lok promotes inclusive growth for underserved populations by investing in enterprises that provide affordable basic services, primarily in financial inclusion, healthcare, and agriculture. It typically works closely with investees to improve their business operations and help them scale to achieve commercial viability. Given Lok’s social mission, it seeks investees who adopt a customer-centric approach that focuses on client protection for low-income individuals. Lok typically also attempts to help investees enhance their impact by developing and tracking social performance policies and metrics.

Lok Capital’s first fund (Lok I, USD 22 million raised in 2006), focused on investments in Indian microfinance institutions. That fund has been fully liquidated. Its second fund (Lok II, USD 64 million raised in 2012) has returned over 100% of invested capital to its limited partners and is set to liquidate in 2020. Lok III has completed a second close at USD 80 million out of a target USD 100 million. Most of Lok’s limited partners are institutional investors, such as pension funds and DFIs.

## Lok’s approach to exits

Lok considers its exit strategy from the early stages of each investment, noting the importance of clearly understanding the interests and long-term goals of a company’s owners or promoters. For example, some promoters may feel a deep sense of ownership in a company, aiming to manage it for a long time or to pass it on to family members; such promoters may not be open to an exit that entails a change in control. Others may wish to sell the company and proceed to start a new business. The promoter has stayed closely involved after most of Lok’s exits, which, Lok’s Managing Director Venky Natarajan explains, helps to maintain a consistent business model and adhere to mission.

Lok also emphasizes the need to remain pragmatic and open to adapting strategy to changing circumstances. If the promoter

does not stay involved, Lok tries to ensure a responsible exit by screening potential buyers for mission alignment and strategic fit, as well as for the attractiveness of their financial offers. Lok believes that once a company is ready to scale, it has fulfilled its role as a seed investor. Institutional investors, especially those with significant experience in the sector, are then better equipped to provide the commercial capital and resources needed for scale. Lok seeks buyers that believe in the business proposition and intend to grow the company without drastically altering its core business model. Lok thus seeks to understand potential buyers' plans to grow the company, screening for risks such as plans for major consolidations that could lead to employee layoffs.

Lok Capital has completed many exits it has deemed successful in terms of both maintaining mission alignment and achieving attractive financial returns. Most have taken place through strategic sales, secondary sales, or through IPOs. While most of Lok's exits have successfully ensured mission continuity, for this case, Lok shared an example where the outcome was less than ideal in order to provide a rich opportunity for learning.

### Background on the investment

As part of its first fund, Lok Capital invested approximately USD 1.75 million in 2009 into an Indian microfinance institution for a 24% equity stake in the company. The company provided microloans to low-income customers located primarily in one Indian state. Lok invested with the aim of helping the company refine its processes and operate more efficiently by using technology, for example, such as tablets for field staff. It also intended to help the company expand its offerings to neighboring states over a projected five-year period.

### Exit objectives and considerations

In 2014—five years after the initial investment and with the end of Lok's first fund approaching—Lok began to seek an exit. In fact, Lok had begun to seed potential buyers in 2012, hoping to find one that understood the microfinance sector and could provide the necessary growth capital. Though the company was profitable and growing, neither the promoter nor Lok could attract a mission-aligned minority investor, in large part because the company conducted 80% of its business in three Indian states, posing what some potential follow-on investors deemed concentration risk.

Given the timing of the fund's close, the best available exit option was to sell a majority stake in the company to a strategic buyer: a gold loan company that sought to secure a banking license and saw the microfinance business as complementary to their existing business. Though generally knowledgeable about financial services, the gold loan company had limited expertise in microfinance or with the specific target customer segment, making them a less preferable buyer from an impact perspective. In this example, the strategic acquisition was also less than ideal, since it opened the door to a possible change in management. Since there were no other investors in the cap table (that is, the promoter owned the rest of the shares), it was relatively easy to manage the exit process.

## Results and lessons learned

Overall, the investment achieved both Lok's financial objectives and its impact objectives to improve the company's processes and grow its operations at a reasonable pace. However, Lok believes the company faces post-sale risks. Natarajan noted specifically that the company's growing loan sizes and "excessive" growth might indicate less regard for client protection, due in part, he believes, to the change in management after acquisition.

As an alternative to selling the whole company, Lok could have rolled its shares from the first fund over into Lok II. However, Natarajan explained, Lok I's limited partners preferred to have their capital returned rather than own a stake in the second fund. Another alternative, to extend the life of the fund, would also have inhibited limited partners' ability to liquidate.

Lok gained valuable experience in this case. Timing was central; a more flexible time horizon would have allowed Lok to hold the company for longer while searching for a more aligned buyer. But the fund had to adhere to its timeline for returning capital. In retrospect, said Natarajan, one viable option could have been to ask shareholders to move their shares to an alternative structure, such as a holding company; the holding company would then have owned the business, allowing it to continue operating while the fund liquidated.

In this case, the drawbacks of a closed-ended fund became evident in light of Lok's impact objectives. The case also highlights the potential for investors to use creative structures, such as holding companies, in approaching and solving complex situations in ways that are tailored to best fit investees' needs and long-term impact.

## CASE STUDY

# BEARTOOTH CAPITAL'S EXIT FROM MONTANA RANCLAND

### Background on the investor

Founded in 2005, Beartooth Capital is a real assets investment firm that has acquired nearly 25,000 acres in the Western United States with the intent to restore and rehabilitate degraded wildlife habitats, waterways, and ranchlands. The firm has managed nearly USD 70 million in assets and targets market-rate returns alongside conservation benefits, believing that financial and ecological value are naturally aligned. Beartooth Capital's work creates positive environmental impact through biodiversity and wildlife protection and downstream water-quality improvements. After restoring its properties, the firm leverages its network of brokers, partners, and community members to find appropriate buyers, often likeminded conservationists who share its same values of ecological and wildlife preservation.

### Background on the investment

In 2010, for USD 4.1 million, Beartooth Capital purchased a 1,050-acre ranch near Bozeman, Montana, that had degraded water systems and wetlands. Degradation of one of the streams, a straight irrigation ditch installed generations ago, led to a fast water stream that supported little fish life. Another creek on the property had become full of silt, which leads to poor water quality and disrupts the natural food chain and vegetation.<sup>20</sup> These two main streams needed significant work to improve fish habitats.

Beartooth Capital acquired the ranch because it saw an opportunity to generate both a good financial return and positive environmental outcomes, even considering the amount of work needed to rehabilitate the property. This suited the firm's aim to target undervalued land and raise its property value by increasing its agricultural or recreational productivity.

<sup>20</sup> Silt is a form of sediment resulting from soil erosion, which "the Environmental Protection Agency lists as the most common pollutant in rivers, streams, lakes, and reservoirs." Mid-America Regional Council. "What is Sediment Pollution?" [https://cfpub.epa.gov/npstbx/files/ksmo\\_sediment.pdf](https://cfpub.epa.gov/npstbx/files/ksmo_sediment.pdf).

## Key Details

### Investor description

Real assets investment firm targeting conservation and market-rate financial returns

### Sector

Real Estate (Ranchland)

### Geography

Western United States

### Investment

1,050-acre ranch near Bozeman, Montana

### Instrument

Real assets

### Holding period

Five years

### Exit mechanism and scope

Full exit

Source: Beartooth Capital



The firm restored the ranch's streams by deepening its main creek, re-meandering the irrigation ditch, adding gravel to the creek bed, and planting trees and bushes to provide shade. Though it was the only investor in this project, Beartooth Capital worked with Montana Fish, Wildlife, and Parks and Montana Trout Unlimited to assess the streams and river areas, engaged contractors to restore the streams to pristine conditions, and consulted with legal teams on issues regarding property rights. The firm planned for the work to take two to three years, after which the search for a buyer would begin.

### Exit objectives and considerations

Before acquiring a property, Beartooth Capital typically considers the expected profile of a potential buyer, which depends on the property's intended use (e.g., agriculture, recreation). The firm knew that their conservation goals for the Bozeman property would be sustained by a buyer that intended to use the ranch for recreational purposes, such as game hunting, fishing, horseback riding, and hiking. Sten Anderson, Finance Director at Beartooth Capital, noted, "We knew that because of the ranch's size and characteristics, it didn't fully support a 100% agricultural buyer. We did some stream and habitat restoration on the ranch, so we knew that we were going to be focusing on a recreational buyer and trying to ultimately sell it to them."

By 2012, having completed the property's rehabilitation, Beartooth Capital and its partners began to search for a buyer. As with any ranch real estate transaction, Beartooth Capital lists its properties with well-known ranch brokers. Yet the firms' brokers understand its mission and what they seek in a buyer. Beartooth Capital received multiple offers, ultimately selling the property to a mission-aligned family who wanted to continue the wetland reservation and preserve the land in posterity for future generations. As Sten Anderson noted, "It was exciting to see that they wanted to maintain and carry on the conservation work that had been done."

*Source: Beartooth Capital*



## Results and lessons learned

Through sale of the property, Beartooth Capital achieved a positive financial return while also meeting its conservation goals. A broad range of wildlife returned to use the property, including deer, waterfowl, game, and songbirds. According to Anderson, the restoration work “brought back fish into the system that people had not seen in generations.” The ranch increased its recreational value for activities such as fishing, hunting, and wildlife observation, while also achieving its objectives in terms of biodiversity preservation and water-quality enhancement.

Though Beartooth Capital secures conservation easements on some of its properties, they decided not to do so in this case, which facilitated the sale of the ranch. A conservation easement is a legal agreement that permanently protects a property from development, particularly for land perceived susceptible to risks such as deforestation or commercial development. Beartooth Capital and its partners assess each investment to determine whether a conservation easement will provide both financial and ecological value to all parties involved in the deal. Although easements have demonstrated successful financial and conservation results, Beartooth Capital also considers that restrictions on how future property owners may use the land can discourage bids. In this case, the ranch near Bozeman had only a small amount of land where a structure or structures could conceivably be built, so the firm determined that a conservation easement would not have provided significant value.

Beartooth Capital ultimately held the land for six years, longer than it had initially planned. The length of time was due in part to the nature of the ranch market in the Western United States, where buyers are somewhat rare and the real estate crash of the late 2000s still affects buyers and sellers. Beartooth Capital was also willing to hold the property until they found the right buyer, one whose planned use of the property met their expectations. The firm has found it useful to plan for scenarios where they may need to hold a property for longer than expected to ensure they meet both their financial goals and their intended continuity of conservation benefits.



## Key Details

### Investor description

Private equity fund manager

### Sector

Financial Services

### Geography

Ghana

### Investment

Life insurance company

### Instrument

Private Equity

### Holding period

Two years

### Exit mechanism and scope

Strategic buyer, full exit

*Photo source: LeapFrog*



## CASE STUDY

# LEAPFROG'S EXIT FROM EXPRESS LIFE

### Background on the investor

LeapFrog Investments is a private equity firm founded in 2007 that invests in financial services and healthcare companies targeting underserved and low-income populations, primarily in Africa and Asia. The firm generally invests in small to medium-sized companies seeking to scale. Having raised over USD 1 billion, LeapFrog invests in “purpose-driven businesses” to facilitate growth, profit, and social impact.

The fund manager’s investment sizes range from USD 5 to 50 million, and most investments offer LeapFrog representation on the company’s board. LeapFrog typically holds investments for four to seven years before exiting through an IPO, trade sale, or management buyback. According to Sam Duncan, Head of Impact at LeapFrog, “Every time we invest in a company, our goal is to make sure that by the time of exit the emerging consumer strategy of the company is scalable and profitable.” Leapfrog’s goal is to ensure that anyone who buys the asset encounters no tradeoffs between financial and social goals. “We want to get the company to that point of ‘no tradeoff’ before we exit, because we believe that’s the most sustainable approach to impact in exits.”

### Background on the investment

Ghanaian entrepreneur Obed Danquah founded Express Life in 2009 to provide life insurance products and services in Ghana, where, at that time, less than 2% of the country’s 25 million residents had coverage. In addition to addressing this local market gap, the company saw opportunity for significant growth in an industry that was expanding by 40% per year.<sup>21</sup> However, Express Life needed to improve its operations, management, product offerings, and sales force to capitalize on this potential. It also had to comply with capital requirements introduced in Ghana in 2011 for domestic risk carriers.<sup>22</sup>

21 “Fund: Financial Inclusion Fund I,” LeapFrog Investments, accessed July 31, 2017, [http://www.leapfroginvest.com/portfolio\\_fund\\_categories/financial-inclusion-fund-1/](http://www.leapfroginvest.com/portfolio_fund_categories/financial-inclusion-fund-1/).

22 Emerging Markets Private Equity Association (EMPEA), “Express Life Insurance Company Ltd. (Ghana),” (case study, EMPEA, Washington, DC, September 2013), <https://www.empea.org/research/impact-case-study-express-life-insurance-company-ltd/>.

In May 2012, LeapFrog invested USD 5.5 million for a majority stake in Express Life, seeing an opportunity to make the company more effective and to further its mission to expand access to critical financial services for underserved communities. At the time of investment, the company had 68 employees and reached nearly 60,000 Ghanaians with insurance coverage. LeapFrog and Express Life aimed to collaborate on a mutual mission to expand insurance coverage to 500,000 low-income Ghanaians over the course of a four-to-six-year investment period. To achieve this objective, LeapFrog worked with Express Life to:

- establish a new senior management team and improve the company’s corporate governance and insurance risk management to align with global best practice;
- review six existing life insurance products and relaunch a simpler offering—two distinct, yet simple solutions that were easy for customers (beneficiaries) to understand;
- expand an agency network from 42 agents in 2012 to 251 agents by 2013, with an increased number of physical branches; and
- leverage BIMA, a company in LeapFrog’s portfolio, to expand distribution of Express Life’s products through mobile phones.

## Exit objectives and considerations

Express Life performed well fairly quickly in terms of impact and financial goals. By December 2013, it had transformed from a small insurer into a leader in the local market, reaching nearly 860,000 low-income Ghanaians—exceeding its goal of 500,000 by 80%. This fast growth clearly demonstrated that Express Life needed growth capital to continue expanding, capital beyond what LeapFrog could provide. The time was appropriate for LeapFrog to consider exiting to an investor that was better-equipped to get Express Life the resources it needed to scale.

Because LeapFrog’s portfolio companies share its “profit with purpose” philosophy, Leapfrog believes their social impact and mission can be sustained post-exit, as long as the follow-on investor is philosophically aligned with the business model. Specifically, LeapFrog seeks buyers that recognize the value proposition in serving low-income populations in emerging markets. Prudential Plc (“Prudential”), the UK’s largest insurer by market capitalization, expressed interest in purchasing a stake in Express Life. Prudential sought to establish a presence in Africa, recognizing the value proposition of serving high-growth, low-income populations there. In LeapFrog’s assessment, Prudential demonstrated this understanding and had the resources and insurance industry experience needed to help Express Life scale. Prudential worked with LeapFrog and Express Life to understand the risk profile and characteristics of the Ghanaian insurance market, buying the stake in March 2014.

## Results and lessons learned

LeapFrog’s investment in Express Life provided several benefits for its stakeholders in Ghana, including both customers and employees. As a 2013 *Financial Times* article on the sale noted, “customers of Express Life pay as little as the equivalent of 70 cents per month for its offerings. These are often sold via mobile phones and include health and life insurance, funeral cover, and savings products.”<sup>23</sup> Besides providing nearly one million individuals with insurance, Express Life

23 Alistair Gray, “Prudential Moves into Insurance in Ghana,” *Financial Times*, December 5, 2013, <https://www.ft.com/content/4b1536b8-5daa-11e3-b3e8-00144feabdc0>.

grew from 68 full-time employees in 2012 to 320 by the end of 2013, a nearly 400% increase. The company's revenue similarly increased, growing by five times. Duncan observed, "Buyers that value profit with purpose will likely pay more for businesses when you can demonstrate integrated results."

Express Life was LeapFrog's first full exit. One lesson from the exit is the importance of a commercial case for social impact, particularly one that helps the acquirer understand how the business model inherently creates impact. As Duncan explained, "It doesn't make sense to bind an acquirer to a social mission, because once you do, it's not an incentive but rather an obligation. This is a commercial strategy, and the most sustainable way to achieve social impact is to make it commercial. And the best way to get commercial returns is to invest in the emerging consumer. We hold true to that in our investment framework."

LeapFrog's experience with Express Life helped the firm establish a tripartite framework for how to responsibly exit its investments, one which gives equal consideration to the following financial and social factors:

- Maintain focus on emerging consumers. The follow-on investor should see the opportunity in serving emerging consumers and have the capital, resources, and strategic alignment to help the portfolio company continue to do so.
- Preserve positive treatment of the company's employees. The follow-on investor should plan to help company management maintain or improve corporate governance and labor practices.
- Secure target financial returns for limited partners.

In general, LeapFrog feels that a strong relationship with the portfolio company is an important factor to ensure that the social mission stays intact after exit. According to Oyin Anubi, LeapFrog's Knowledge Manager, "We can be confident that the emerging consumer strategy will continue when we have a good relationship with the portfolio company." The key element is to ensure that the mission becomes embedded in the company's culture.

Source: LeapFrog



# Appendix 1. Interviewees

**Vikas Raj**

*Accion Venture Lab*

**Rodrigo Villar and Erik Wallsten**

*Adobe Capital*

**Ada Arevalo and Jun Sakumoto**

*Avanath*

**Sten Anderson**

*Beartooth Capital*

**Shawn Lesser, Nancy Rosenzweig,  
and Michael Whelchel**

*Big Path Capital*

**David Osborne**

*CDC Group*

**Alexander van der Have**

*DOEN Foundation*

**Sandeep Farias, Amie Patel,  
and Johanna Posada**

*Elevor Equity*

**Steven van Weede**

*Enclude*

**Chris Herrmann**

*Enterprise*

**Annette Berendsen**

*FMO*

**Stuart Barkoff**

*Global Environment Fund*

**Anna Kanze**

*Grassroots Capital Management*

**Brian Cayce**

*Gray Ghost Ventures*

**Oyin Anubi and Samantha Duncan**

*LeapFrog Investments*

**Oliver Karius**

*LGT Impact Ventures*

**Sarika Mendu and Venky Natarajan**

*Lok Capital*

**Liz Adams and Peter Stein**

*Lyme Timber*

**Neeraj Aggarwal and Geeta Goel**

*Michael & Susan Dell Foundation*

**Jeff Hom**

*Omidyar Network*

**Annie Roberts**

*Open Capital Advisors*

**Susan Phinney Silver**

*David & Lucile Packard Foundation*

**Aner Ben-Ami**

*Pi Investments*

**Jean-Gabriel Dayre**

*Proparco*

**Peter van der Werf**

*Robeco*

**Jason Winship**

*Sea Change Capital*

**Veena Mankar**

*Swadhaar*

**Rekha Unnithan**

*TIAA Investments*

**Andrea Armeni**

*Transform Finance*

**Anne Amanda Bangasser**

**and Dominique Bangasser Slavin**

*Treehouse Investments*

**Caspar Sprokel and Gera van Wijk**

*Triodos*

**Emily Stone**

*Uncommon Cacao*

**Nick Ashburn and Harry Douglas**

*Wharton Social Impact Initiative*

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# Appendix 3. Summaries of relevant literature

## A Practical Guide to Planning and Executing an Impactful Exit

In 2014, the European Venture Philanthropy Association (EVPA) published *A Practical Guide to Planning and Executing an Impactful Exit*. Reviewing existing literature and convening 24 experts to create a framework to help venture philanthropists and social investors develop strategies to ensure impact continuity post-exit, EVPA identified a five-step process:<sup>24</sup>

1. Determine key exit considerations, such as goals for social and financial returns, sector and geographic focus, funding instrument, and the investor's relationship with other funders.
2. Develop an exit plan, in collaboration with the investee, that defines timeline, investment milestones, mode of exit, and market forecasts.
3. Determine the investees' exit readiness by monitoring the implementation of the exit plan, correcting any deviations.
4. Execute the exit by selling to a new investor that can better support the investee, selling to the investee, or liquidating the business.
5. Attempt to follow up after investment to evaluate lasting impact (for example, by staying in touch through networking events or technical assistance).

According to the report, to help ensure long-term impact, the exit strategy should be integrated into the investment process and strategy, and investors should assess the investee's ability to progress on three dimensions: (1) social impact, (2) financial sustainability, and (3) organizational resilience (that is, the maturity of the investees' management team, capacity, and organization). The goal of this assessment is to leave the investee in a strong position to sustain the investment's long-term objectives. Nevertheless, the report does acknowledge that more case studies and examples of exits should be gathered to further develop an understanding of the exit processes venture philanthropists and social investors use, as well as gathering additional data to reinforce and enhance its findings.

## The Art of the Responsible Exit in Microfinance Equity Sales

The 2014 report by the Consultative Group to Assist the Poor (CGAP) and the Center for Financial Inclusion (CFI), *The Art of the Responsible Exit in Microfinance Equity Sales*, described how investors can exit their equity investments from microfinance institutions (MFIs) in ways that maintain an institution's long-term social objectives and further develop the microfinance market. From over 40 interviews regarding equity sale transactions, the report concluded by recommending no single approach to a responsible exit. The variety of issues investors face in leaving an investment, such as a market's status at the time of exit and the microfinance institution's

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<sup>24</sup> EVPA defines a "venture philanthropist" as an individual, either independent or affiliated with an organization, who is engaged in a high-engagement and long-term approach to generating social impact through tailored financing, organizational support, and impact measurement and management. A "social investor," according to EVPA, invests in organizations that primarily aim to achieve measurable social and environmental impact more than financial returns.

governance and organizational structure, lead to four strategic questions to guide investors toward a responsible exit:

- **When?** Determining the desired timing and avenue of exit should be a critical component of the investor's decision to invest. All equity investors involved in an exit should also discuss the timing and maintain a strategy sufficiently flexible to adapt to change.
- **To Whom?** Investors need to weigh the advantages and disadvantages of selling to a microfinance versus a non-microfinance investor, using a careful and thorough due diligence process to determine fit. Microfinance investors will likely have similar, mission-driven investing objectives, while a non-microfinance investor can likely provide more capital, more in-depth technical expertise, and local market knowledge beyond the microfinance sector.
- **How?** To help ensure that social objectives continue after exit, provisions in shareholder agreements that specify mission-oriented objectives and governance structures can reinforce the socioeconomic goals of the investment (one example is a right of first refusal, where the exiting investor preserves the option to buy shares before a third party can). However, these provisions may be difficult to enforce and can even delay or impede the exit if they are not met.
- **How Much?** Presenting a hypothetical microfinance equity exit scenario to a group of investors, the report found that, in leaving an investment responsibly, investors typically screen buyers first on mission alignment, and then by price. The report suggests additional avenues of research to better understand the extent to which DFIs and microfinance investment intermediaries seek to maximize their profits during an exit, along with revealing the expectations that raises for an investee's ability to deliver profits and growth.

The report also described how DFIs can leverage responsible exits to set examples for the microfinance market regarding how to leave investments responsibly. Further research on responsible exits, it recommended, should focus on active governance structures, new equity investing models, and sharing best practices for balancing financial returns with social objectives.

## Great Expectations: Mission Preservation and Financial Performance in Impact Investing

Published in 2015, the Wharton Social Impact Initiative's (WSII) *Great Expectations: Mission Preservation and Financial Performance in Impact Investing* report explored the commonly asked question: must impact investors face a tradeoff between financial returns and social and environmental impact? Posing this question to understand the link between preserving both liquidity and mission, the report seeks an answer by examining:

1. the extent to which impact investing private equity fund managers have legal permission to pursue impact-related factors during exit, how they can exercise control over an exit or influence its outcomes well after the investor leaves, and whether invested companies stay on-mission after-exit; and
2. how impact investments have performed financially compared to those that are not impact-driven.

Surveying 53 impact investing private equity funds representing 557 individual investments, the report found the following:

- All General Partners (GP) reported that Limited Partners (LP) permitted or required them to pursue impact during the investment process, with 90% of GPs having formalized agreements through Limited Partner Agreements or Private Placement Memoranda.
- GPs usually do not have controlling interests in their portfolio company or a presence on the board of directors. Therefore, they have little control over exit decisions. However, they remain optimistic about sustaining mission preservation at exit, because they commonly identified social and environmental impact as part of investees' business models during pre-investment screening.
- Funds can achieve market-rate returns while preserving social and environmental impact.

The report suggested that questions remain about GPs' responsibilities to encourage long-term impact, including whether they should stay actively involved with companies after exit. Also, investors require more data on social impact metrics before and after exit, along with clarity on the long-term impact for which they are accountable.

## Growing a Hybrid Venture: Toward a Theory of Mission Drift in Social Entrepreneurship

"Growing a Hybrid Venture: Toward a Theory of Mission Drift in Social Entrepreneurship," a PhD dissertation Liudmila Chambers submitted in 2014 to the University of St. Gallen, addressed how social entrepreneurship organizations experience mission drift when growing and attempting to balance the dual objectives of revenue generation and maximizing social welfare. The dissertation used organizational identity theory to measure the degree to which normative and utilitarian factors influence social entrepreneurship organizations' missions, based on interviews with ten organizations. It sought to understand which identity (normative or utilitarian) was most dominant within each organization and to what extent. The findings suggested that organizations that are dominantly influenced by normative factors (e.g., addressing social or environmental problems) are less likely to experience mission drift. In turn, organizations influenced mostly by utilitarian factors are more likely to face mission drift, since financial motivations primarily underlie their growth strategies.

The dissertation also highlighted reasons why mission drift causes problems for social entrepreneurship ventures. Mission drift can cause confusion among financial providers about the firm's actual purpose, thereby jeopardizing future funding. It can also lower employees' morale within the organization and result in internal conflicts. The dissertation also included an argument, offered by some scholars and practitioners, that mission drift need not be a negative development, so long as the new mission is properly communicated both internally and externally.







# Additional GIIN Research

The GIIN conducts research to provide data and insights on the impact investing market and to highlight examples of effective practice. The following selection of GIIN reports may also be of interest:

Since 2011, the GIIN has conducted an **Annual Impact Investor Survey** that presents analysis on the investment activity and market perceptions of the world's leading impact investors.



## The Business Value of Impact Measurement

demonstrates how investors and their investees use social and environmental performance data to improve their businesses.



**GIIN Perspectives: Evidence on the Financial Performance of Impact Investments** is a comprehensive review of research on the financial performance of impact investments, synthesizing findings by asset class.



The **Impact Investing Benchmarks** analyze the financial performance of private equity/venture capital and real assets impact investing funds.



The **regional landscape reports** analyze the state of the impact investing market at a country level in South Asia and East, West, and Southern Africa.



**Beyond Investment: The Power of Capacity-Building Support** identifies common, effective practices for capacity-building support in the impact investing industry.



Visit the GIIN's website to find more resources from the GIIN and other industry leaders at <https://thegiin.org>.



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