SOLUTIONS FINANCE SERIES

BEYOND IMPACT INVESTING, TOWARDS SOLUTIONS FINANCE

ISSUE #1

The J.W. McConnell Family Foundation

SOLUTIONS FINANCE

A NEW VISION FOR OUR WORK: BUILDING THE SOLUTIONS ECONOMY

The J.W. McConnell Family Foundation's philanthropic work currently focuses on systems transformation — changing policies and institutional culture in order to address the root causes of societal challenges. We know that challenges such as climate change and sustained inequality and poverty are of such magnitude and complexity that they cannot be addressed by one solution or by one sector alone. Often, significant transformative change of social systems happens at the intersection of multiple sectors, engaging a range of stakeholders in a holistic process.

Current global trends show promise. As we look around the world we see governments, civil society and corporations rethinking their relative roles in building sustainable economies. Even capital markets are shifting. Social innovation and social enterprises are taking a more prominent role in economic, social, and environmental development. Environmental, social and governance (ESG) standards are also increasingly integrated into financial and corporate strategies. The impact investing market is growing and traditional fund managers are entering the "impact" space, recognizing that social and environmental wellbeing in societies is essential to business and financial sustainability.

In summary, we are seeing a global shift towards a **solutions economy.**

SOLUTIONS ECONOMY is an economy in which "solving social problems [becomes] a multidisciplinary exercise that challenges businesses, governments, philanthropists, and social enterprises to think holistically about their role and their relation to others—not as competitors fighting over an ever-shrinking pie, but as potential collaborators looking to bake something fresh that serves as many stakeholders as possible" (Eggers, W.D., 2013).

INTRODUCING SOLUTIONS FINANCE

SOLUTIONS FINANCE is an integrated approach to deploying financial capital and adapting financial models to catalyze, sustain and scale systems transformation. Approaches of solutions finance include responsible investing, granting, impact investing, and financial innovation.

Successful systems innovation requires adequate resourcing and calls for new forms of capital allocation across the multiple stages of design and implementation. In many cases, systems innovation models mature from needing philanthropic dollars to developing solid business models that would allow them to partner with large mainstream investors. However, as we know, market and social system inefficiencies continue to prevent taking innovative models to scale to fulfill their full potential.

This is why the Foundation is shifting its focus to Solutions Finance, an integrated approach to deploying financial capital and adapting financial models to catalyze, sustain and scale systems transformation.

This includes, but is more than, continuing to grow an investment portfolio with the expectation of blended returns. It is about investing in financial innovation, and identifying or adapting financial models to involve stakeholders who would otherwise remain at the margins or work in isolation.

It is also about fostering new forms of collaboration, e.g. between foundations and banks, and leveraging more resources for larger systemic impact, while ensuring community ownership and empowerment of different stakeholders along the way.

Solutions finance is also about converging with trends in the capital markets that are moving towards greater sustainability, and about recognizing the relative role we can all play in driving systems change. It invites every sector and every stakeholder including entrepreneurs, social enterprises, foundations, governments, financial institutions, small businesses, and corporations, to participate in large scale transformation that will help us move the needle on some of the challenges we face, while remaining loyal to their core mandates.

For us as a private foundation, solutions finance is also about the strategies that allow us to better integrate our various financial assets — grants, impact investments, and more traditional investments — to have a greater impact.

The Foundation is embracing solutions finance after a decade of supporting the development of social finance and the impact investing marketplace in Canada, learning from various successes and failures in managing impact investments.

SOLUTIONS FINANCE: AN INTEGRATED APPROACH

IMPACT INVESTING INCLUDES:

- Debt and equity
- Public and private
- Direct and indirect
- Concessionary or risk-adjusted market-rate of return

GRANTING FOR:

- Capacity Building
- Transition and Growth
- Investment Readiness

RESPONSIBLE INVESTING THROUGH:

- Negative/Positive Screening
- Shareholder Activism
- Community Investment

FINANCIAL INNOVATION THROUGH NEW:

- Models
- Co-Investment
- Valuation
- Instruments

OUR JOURNEY IN IMPACT INVESTING

IMPACT INVESTING **is an investment strategy aimed at *intentionally* creating positive societal impact beyond generating financial return, sometimes deployed within a larger solutions finance strategy.**

MISSION-RELATED INVESTMENTS (MRIs) **are impact investments in line with the Foundation's mission with an expectation of market or above-market financial returns.**

PROGRAM-RELATED INVESTMENTS (PRIs) **are impact investments that further the Foundation's program objectives and have a tolerance for below-market financial returns.**

The Foundation became an impact investor in 2007, making a $10 million bridge loan to finance the construction of Quest University. The loan was repaid in full with 5% interest in 2009. This was an important milestone for us. The experience of making a direct investment in a grantee, and making a decent return at a time when the financial markets were going through great instability, gave us the confidence to explore more options for impact investing. In 2009, our Board mandated that we allocate 5% of total assets under management to impact investing. In 2010 we made our second impact investment, of a very different type, in a private equity fund.

Commitments since inception: **$45M**
Current commitment: **$32.6M (5.34% AUM)**
No. of current commitments: **15**
No. of active investments: **10**
PRI-MRI allocation: **7 PRIs ($9M) and 8 MRIs ($23.6M)**
No. of successful exits: **2 ($12M)**
No. of losses: **2 ($270K)**

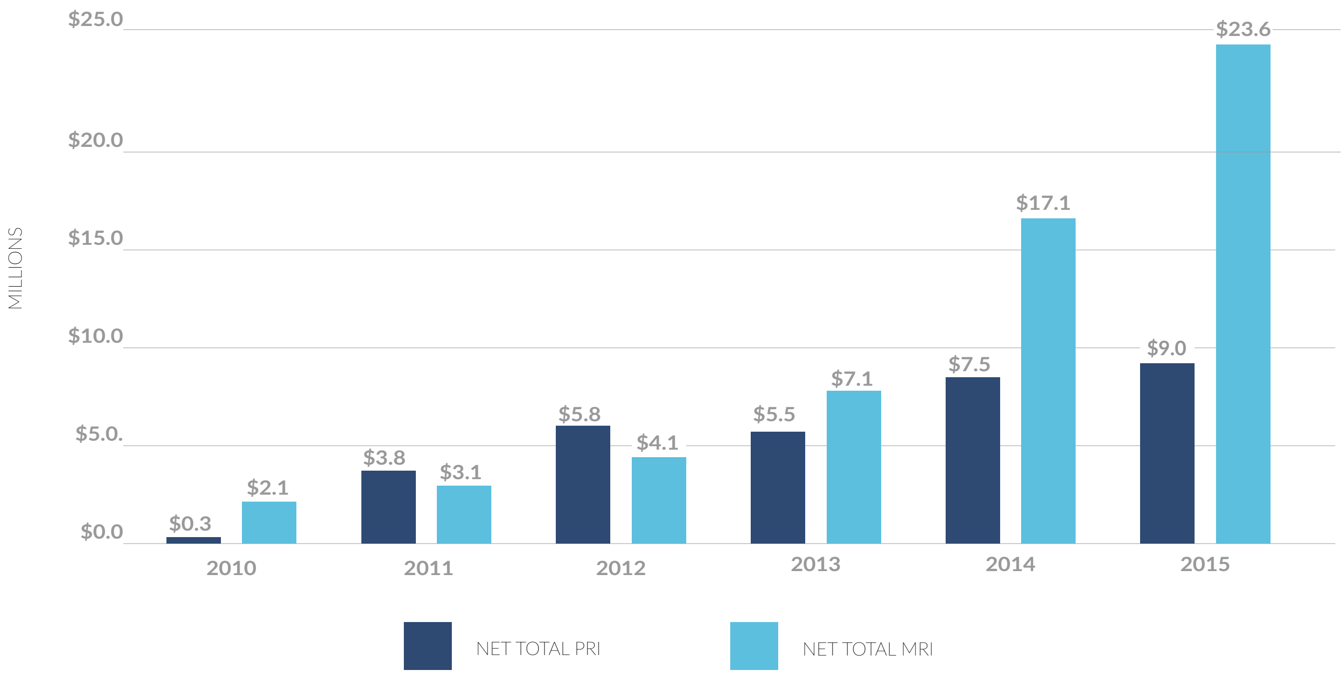
In 2015, we reached the 5% target. The Foundation's $32 million impact portfolio is made up of 15 investments with diverse risk-return profiles (both on impact and financial dimensions), with expected returns that range from repayment of principal to expected internal rate of return (IRR) of 25%. The investments are directed to charities, non-profits, for-profit social ventures, co-operateives, and for-profit start-ups and corporations in the different domains of the Foundation's programs.

IMPACT INVESTING DOMAINS

They are also spread across a range of asset classes and instruments: public equities, private equity, debt instruments and guarantees.

TOTAL PORTFOLIO SIZE BY INVESTING CATEGORY

(AMOUNTS REPRESENT TOTAL COMMITTED CAPITAL AT END OF YEAR)



All these investments contribute to one or more of the Foundation's impact investment portfolio goals: to increase social and environmental impact, in line with Foundation priorities; increase capital available to the charitable sector; and support financial innovation, and thus, the growth of the marketplace.

The portfolio represents an initial step in deploying multiple Foundation financial resources, in addition to granting, to support its mission.

WHAT WE'VE LEARNED SO FAR

Through implementation of our portfolio, we now know that—

- Impact investing can be applied across multiple asset classes, touching on a range of organizations contributing to positive societal transformation at different levels of scale.
- Impact investments do not necessarily come with an inherent trade-off between financial and social returns.
- Integrating financial capital - grants with investments - enables adaptation and scaling of promising projects that neither activity could achieve alone; relatively small investments can potentially lead to transformational opportunities at a larger scale.
- For impact investments to perform, domain expertise must be matched with rigorous and prudent investment practices.
- PRIs offer a powerful leverage of philanthropic capital for social impact but are more challenging to implement. The market for MRIs is larger, more mature, and growing quickly; it has already entered mainstream markets.
- With the right tools and processes, fiduciary duty is not incompatible with impact investing.

These and other lessons are unpacked in subsequent issues of this series.

THE J.W. MCCONNELL FAMILY FOUNDATION

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