

DISCUSSION OF:

*Contracts with Benefits: The Implementation of
Impact Investing*

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Discussion by:

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Agenda Here:

Condensed Version of What You Have, but Focused on How I would Pitch

1. Take as given that investors have utility over impact
 - Andreoni 1989, 1990; Niehaus 2014 ; Hart and Zingales 2017; Barber Morse Yasuda 2017
2. Ask how contracting assures impact motive is implemented, taking the entrepreneur as an agent
 - [Over and above the VC contracting environment from Kaplan and Stromberg (2003)]
 - Main complication of impact investing: Incentivizing within a Multitasking environment (Holmstrom and Milgrom 1991)

Comment 1a: Keep it simple

Do not try to replicate Kaplan & Stromberg (ReStud, 2002)

1. Entrepreneur cash flow compensation function is more sensitive to performance when asymmetric information problems are more severe, consistent with Holmstrom (1979), Lazear (1986)
2. VC-entrepreneur control rights allocation is a central contract feature, supporting incomplete contracting of Grossman and Hart (1986) and Hart and Moore (1990).
3. Cash flow & control rights are contingent on performance consistent with shifting control in low outcome states, such as in Aghion and Bolton (1992) and Dewatripont and Tirole (1994).
4. Non-compete and vesting provisions indicates that VCs care about the hold-up as in Hart Moore (1994).

Instead:

- Smaller set of hypotheses, only going after you addition to the literature, which is the multitask. You don't have the data to do more.

Comment 1b: Keep it simple

Investor-Fund (LP-GP) Comparison

- You have 14 NMRS and 29 MRS

Recommendation:

- Drop the comparison of LP-GP contracts altogether.
- The interesting [identifiable] contracting is with the portfolio companies anyway
- Observations =43 is not enough
 - Especially when you need multivariate controls for different fund stages, etc

Comment 2: Impact Investing Definition

Global Impact Investing Network (GIIN):

“... industry powered by investors who are determined to generate social and environmental impact as well as financial returns.”

- Very different from both SRI/Responsible Investing & philanthropy
- **Intentionality in both social/environmental & financial returns**

Comment 2: [Abridged] Landscape of Impact and Responsible Investing

These have negative expected returns.

Grants

(i) **Venture Philanthropy**
(ii) Negative Return Subsidized Loans

Philanthropy

These have lower than market expected returns.

(i) **Social or Mission Funds**, (ii) Development Bonds

(iii) **Dual Objective VC**, (iv) Some Green Bonds, (v) SRI below market

GIIN:Impact Investment

These **aim** for market-rate financial returns

(i) **For-profit VC/PE in Impact Sectors**, (ii) SRI Funds in Equities & Bonds (iii) Real-Assets Asset Classes (timber, land)

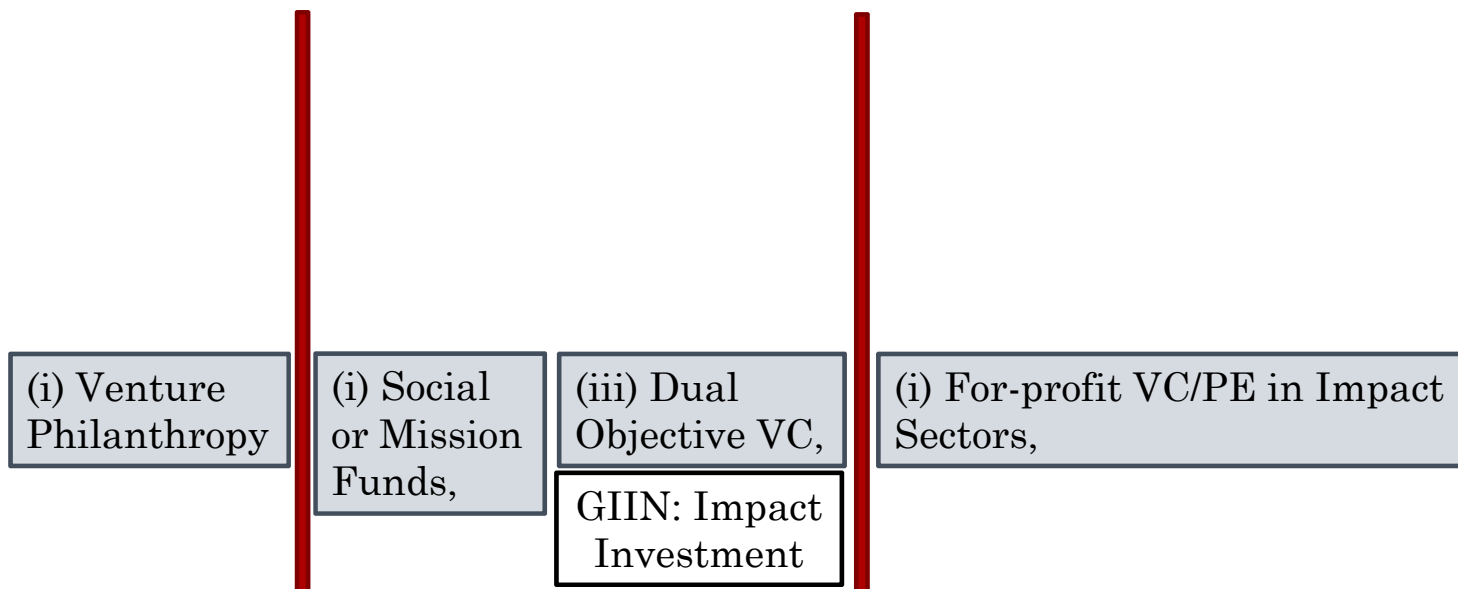
For-Profit Impact Sector VC, SRI, Responsible Investment

Impact Investment (Broad Definition)

Impact Investment (This Paper)

Social Returns

Financial Returns



Comment: I'm concerned about: MRS vs NMRS.
 "What is the statement that best describes the fund's financial return goals?"
 MRS: "Targeting competitive, market rate returns,"
 NMRS: "Targeting below market, but close to market returns,"
 "Targeting below market, close to capital preservation returns"



These don't often say (or believe) that they target below-market returns.

(i) Venture Philanthropy

(i) Social or Mission Funds,

(iii) Dual Objective VC,
GIIN: Impact Investment

(i) For-profit VC/PE in Impact Sectors,

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NMRS This Paper

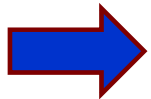
MRS This Paper

Social Returns

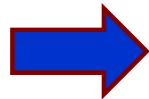
Financial Returns

These are social entrepreneurs needing profit incentives, not entrepreneurs needing inducement for impact

These don't often say (or believe) that they target below-market returns.



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NMRS This Paper

MRS This Paper

Social Returns

Financial Returns

Punchline Comment 2:

What is impact investing in you data vis-à-vis the literature?

Who is willing to answer that survey question?

- My prior:
 - These are social-first or mission funds or even venture philanthropy
- Question then:
 - How contract gets them to go after profits, not how to get them to be impactful
- Versus paper's view:
 - “The addition of social impact to the objective of a profit-seeking firm”

Comment 3: Comparing apples- with-apples?

Contact terms differ by
stage of investment and
exposure of VC/PE to
portfolio company

I don't think you can
get by without
controlling for these
and other
characteristics
(industry, etc) that
matter for term sheets
in estimation

	MRS		NMRS	
Number of funds	8		6	
Documents / Companies (?)	57		25	
<hr/>				
Ownership				
5% <= Own < 10%	1	1.70%	4	15.40%
10% <= Own < 15%	6	10.30%	0	0.00%
15% <= Own < 20%	4	6.90%	2	7.70%
20% <= Own < 25%	13	22.40%	0	0.00%
25% <= Own < 30%	6	10.30%	1	3.80%
30% <= Own < 40%	9	15.50%	3	11.50%
40% <= Own < 50%	3	5.20%	0	0.00%
50% <= Own < 60%	2	3.4%	0	0.00%
Own >= 70%	4	6.9%	0	0.00%
Unknown	10	17.2%	16	61.5%
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Stage focus				
Growth	4	6.9%	1	3.80%
Growth: Early-stage	1	1.7%	0	0%
Growth: Pre-seed / Seed	8	13.8%	0	0%
Mature	2	3.4%	2	7.7%
Unknown	43	74.1%	23	88.5%

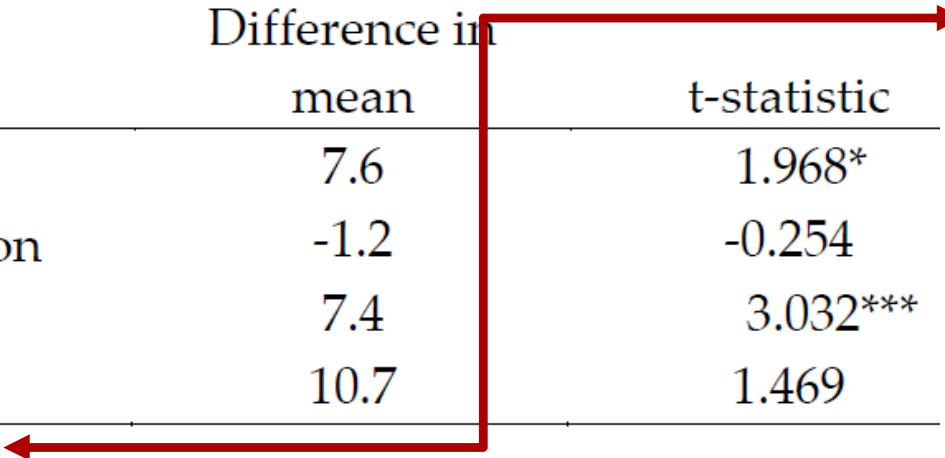
Comment 4: How I would organize the paper

- Main table for me in current draft.

Table 7: Governance/Control Dimensions in GP-PC Contracts

Panel C: Differences (MRS-NMRS)

	Difference in	
	mean	t-statistic
Exit control	7.6	1.968*
Investment protection	-1.2	-0.254
Governance	7.4	3.032***
Information rights	10.7	1.469



But these category indexing of the individual contract terms seem to miss insights

New variables from contract terms that more precisely isolate agenda of multitask contracting

Multitask-Focused Vars	Contract Items	Why
1 Impact Measurement	Make an index, but only of MEASUREMENT terms, not having an agenda	Costly to implement, provides 2nd optimization focus
2 Profit - Exit Misalignment	Drag along rights	Social entrepreneurs do not like to sell to non-aligned suitor. Drag-along rights allows investor to force sale to secure profits for LP.
3 Profit - Termination	Put Option, Redemption	Need to terminate if not profitable. Social entrepreneurs like to continue because cannot forgo impact
4 Profit at Acquisiton	Liquidation Preference	Extent to which VC wants swinging for fences versus security of getting money back
5 Control	Board Seats	Impact VCs often back away from board seats to induce profit motive, unless firm is 1st agenda social. Note: Must estimate within ownership bucket.
Not as interesting	Antidilution, Information, Veto Rights, Non-Compete	Quite pervasive even if not observed

Comment 4 Punchline: Reorganization & Tests

- Start with simpler goal in the multitask frame in the GP-portfolio company data
 - Not an undersell.. Very important. But also something you can speak to, while writing a clear economic flow paper.
- Set up the more direct variables (prior slide) in multivariate estimations
 - Don't assume your are trying to induce impact (social entrepreneurs)
 - Do a better job of looking up unknowns
- Then, go to data in the public domain to look for “consistent with”
 - It's easy to say “we don't have the data”, but surely there are relevant data available on portfolio companies
 - Your sample has all kinds of observability concerns. This will mitigate applicability
- Finally, what did we learn?
 - Contracting reflects agenda?
 - Seems like there is more to say here as punchline