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Sir Ronald Cohen: Venture Capitalist to Social Capitalist

Sir Ronald Cohen is one of the founding fathers of modern venture capitalism. Now he is advocating a revolutionary new approach to narrow the widening gap between rich and poor, and wants investors to replace the "invisible hand" with the "invisible heart".

On the face of it modern day venture capitalism would seem to be the polar opposite of social enterprise. Venture capitalists are in business to make a quick – often anonymous – profit on their investments and then sell out; social entrepreneurs put profit second to the needs of their social stakeholders and are in it for the long-term.

So it is perhaps surprising that Sir Ronald Cohen, who founded APAX Partners thirty years ago, should now be a cheerleader for social enterprise. But he believes there is no contradiction in his new role. "I'm motivated by the same idealism in moving from dealing with investment for profit, to dealing with investment for social return. I got into venture capital to do something socially useful."

Sir Ronald Cohen arrived in the U.K. as a refugee from Egypt and after studying at Oxford and Harvard Business School entered the world of finance. Having made his mark in modern venture capitalism he now spends most of his time in the social enterprise field. He is currently chairman of The Portland Trust, he co-founded Bridges Ventures and Social Finance U.K., and he is director of Social Finance USA. In 2012 he received the Rockefeller Innovation Award for innovation in social finance. He has just stepped down as chairman of the U.K. NGO, Big Society Capital.

Widening Wealth Gap

His involvement in social capital and philanthropy began in 2000, when he was given responsibility by the U.K. Treasury to head its social investment task force. "I had realised as a venture capitalist that while the average standard of living rose as a result of my and others' efforts, the gap between rich and poor was actually getting bigger and bigger."

He concluded that there were two reasons why this social inequality had persisted. Firstly, the philanthropic model actually prevented social organisations from scaling up to play the role that they could in theory play. And secondly, that government had neither the tools nor the capital to redress the balance. "The solution was to harness those elements that had made capitalism so successful for the benefit of the social sector. To turn the social sector into the part of the capitalist engine that deals with the social consequences of the system."

A Curtain of Fire

According to the UK Charities commission the social sector, charities and philanthropic organisations have a lot of resources and people – 800,000 in the U.K.. Sir Ronald Cohen estimates there are, 11 million across Europe and 10 million in the U.S. But what they lacked was access to the capital to make the difference. Back in 2002, he warned of the consequences of ignoring this inequality in a speech when he was still heading up APAX. "If we do not tackle social issues very differently, a curtain of fire will come to separate the rich from the poor." The riots in most major U.K. cities in 2011 seem to suggest his comments were remarkably prescient.

His notion of social enterprise, which blends a social return with a financial return to attract capital for the "not for profit sectors", is he admits a revolutionary concept, but it is not new. He believes we are rediscovering Adam Smith's theory of moral sentiment in which he said that, in addition to enlightened self interest, people were also motivated by a desire to help their communities.

"Many of us talk in terms of the invisible hand of the market. For example, the baker bakes to make a profit and if in the end he feeds the poor – everyone is better off. Here we are talking about the invisible heart. People who are motivated to improve the lives of others."

The Invisible Heart

Typically those people and organisations were only able to access philanthropic funds. "Now we're saying to them that you don't have to keep looking only for donations. If you can deliver a social performance we can deliver a financial return. If you can deliver 7 percent on a social impact bond then you can raise £10 million to £20 million in order to build the scale of your organisation into something that can really impact on a social issue that you really care about. So it's all about the invisible heart - it starts with people rather than with money."

The business model that Sir Ronald Cohen uses in his Portland Trust Funds, Bridges Ventures and Social Venture U.K., is the Social Bond – an evolution of the philanthropic model into an "impact investment" model where people who want to achieve a social goal can have access to the same capital as someone who wants to achieve a business goal. Traditionally philanthropic organisations and social "not for profit" enterprises have not been allowed access to the capital markets in the way that for profit businesses have.

Social Impact Bonds

Social Impact Bonds are revolutionising the way that investors measure financial return. They measure the social impact of the work that is carried out by the not for profit organisations and translate that into a financial metric. The first bond was launched in the U.K. in 2010. The aim was to raise money for 3 charities involved in the rehabilitation of prisoners. Instead of seeking donations, Sir Ronald wanted to raise £6 million through a bond issue – the Peterborough Bond – backed by the U.K. government.

In the same way that a venture capitalist takes a calculated risk when he invests in a company that he believes can produce a decent financial return, the money from the Peterborough bond (essentially a contract or bet with the public sector) was invested in the belief that the charities could reduce rates of recidivism through their novel and innovative approach. More than two thirds of young prisoners reoffend within a year of their first spell in jail – at considerable cost to society and the government.

"If the charities failed to reduce recidivism rates by more than 7.5 percent then the investors lost their money. If, on the other hand, these not for profit organisations reduced it by 17.5 to 15 percent then the Ministry of Justice and the Big Lottery Fund would agree to pay back the five million pounds plus the yield on the Social Impact Bond would go from 2.5 percent to 13 percent depending on how successful they were in reducing recidivism. The yield would hit 13 percent return at a 15 percent reduction."

Sir Ronald Cohen believes that the Social Impact Bond is good news not just for government and the investors, but also for the charities involved. Rather than going cap in hand every year to raise donations they have solid additional funding for the six year duration of the bond and they have the ability to scale up their operation. "If you can deliver a 7 percent return on the Social Impact Bond, you can then go back and raise £10 million; instead of dealing with one prison, you can deal with three prisons. And if you need £100 million to do it over time you can raise that." The social bond provides 'not for profit' organisations with an additional layer of capital in its balance sheet, which is performance based."

Sir Ronald believes that the Social Impact Capital is not just for small businesses and "not for profits" and believes that "big business" is embracing it too. "This is the start of a revolution that will change the mind sets of the business world, entrepreneurs and executives. The revolution will begin within the social sectors as they begin to illuminate the ways that different business models have a social impact. As the metrics of the social sector become more sophisticated, big corporations will adopt them and change their business models."

This year for the first time, the INSEAD Entrepreneurship Forum will focus on the world of Impact Investing. ***The INSEAD Entrepreneurship Forum on "Impact Investing: Creating an Industry from Innovations***, *" will be held on the INSEAD*

Europe Campus in Fontainebleau, France on May 23rd, 2013.

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