Meeting on May 16, 2012 between the Omidyar Network, Good Ventures and GiveWell

Participants:

- Omidyar Network: Matt Bannick, Managing Partner; Paula Goldman, Director; Tie Kim, Global Head of Finance; Bill Barmeier, Partner and Head of Investments; Will Fitzpatrick, General Counsel; Todor Tashev, Investment Partner
- Good Ventures: Cari Tuna, President
- GiveWell: Elie Hassenfeld, Co-founder

Cari: To start, I'd like to learn more about your overall strategy. How do you do you decide which groups to support and which groups not to support?

Matt: Let me give you some background about the Omidyar Network (ON), our model, and how we got started. We believe that every individual has the capability to make a difference and therefore what's lacking in the world is equal opportunity. We support organizations that empower individuals and provide them with that opportunity.

We invest early stage in entrepreneurial ventures and market-based solutions. We provide human, intellectual, and financial capital to help organizations scale up and have huge impact. Ultimately, we hope the organizations we support scale to reach millions of people and eventually even create entirely new sectors that impact even more people.

Initially, Pierre Omidyar created a foundation, but he then felt constrained by that structure. Ebay, the company Pierre co-founded, created millions of jobs for regular people working on their own. One of the main groups it created jobs for was single moms who lived at home and sold things. He believed that business can also create very positive social impact but saw a philanthropic sector mostly organized around giving money away rather than also investing it. He asked, "Why should we just give grants? Why don't we also do for-profit investing to accomplish social good?" So, he decided that ON should first focus on the problems it wants to address and then figure out what type of capital to provide whether it's direct grants or investment capital.

Right now, there's very limited capital available to for-profit entities that are trying to achieve social change. In terms of equity investments coming from foundations in the US, we estimate it's only around $25-30 million/year. Foundations do great work giving grants, but if you're trying to create lasting social change, why constrain yourself to grants alone? ON allocates about 50% of our capital to grants and 50% to investments. We do still give that significant proportion of grants because we know there are cases of market failure where traditional philanthropic capital is needed.

We think investment makes a lot of sense because it's hard for nonprofits to reach scale. A recent Bridgespan study showed that in the last 40 years only 200 nonprofits had gone from startup to $50 million in revenue. So, if you really want to reach scale, history says that you need to be open to providing other forms of capital.

In terms of what we support, we started with microfinance and then moved into other areas like government transparency, consumer Internet and mobile (because that's our background in Silicon Valley), education (because that's a huge sector), and base of pyramid entrepreneurship.. We probably do about 60% of our work in the developing world in India and Africa in particular and 40% in the US.

We also do property rights; that's one that very few foundations do. Property rights cuts across areas: health and nutrition, women's issues and more. In India, lack of rights to land is an even bigger driver of poverty than the caste system. On a visit to India, I talked to women who had just received land, and I asked them what impact ownership had had on them, and I expected them to say, "I make more money now." But instead they said, "Now I stand tall." They had dignity, and dignity is so important.

Francis Fukayama at Stanford is associated with the Center for Democracy, Development, and the Rule of Law. The theory of the center is that if you have three things – democracy, development and rule of law – society can advance. Instead of trying to tackle all three of these issues at once, our approach is to take that approach as a framework and map it to the issue areas I described earlier to figure out what to do. We touch each of these three macro areas in ways that are consistent with our approach. This allows us to target our programs effectively.

Roughly speaking, we'll deploy $140 million this year. The average deal size is relatively large. ON will do 60 to 70 ~$2M deals this year.

There's one other element of the model that we find interesting. We'll play in any area that has high social impact whether it has high or low financial returns. Within the set of opportunities that have high social returns, we separate opportunities into buckets depending on the possible financial returns. "A" investments are ones where we expect market returns on capital. We also do "Cs" which are straight philanthropic grants.

Five years ago, we were just focused on As and Cs, and we realized there's a lot more on the continuum between As and Cs. So, to break it down fully:

- As: We believe we'll get risk-adjusted market-rate returns. Usually we co-invest with traditional venture capital firms
- B1s: we think we see risk-adjusted market-rate returns but others don't.
- B2s: we think we'll get below-market-rate returns
- B3s: smaller but non-zero returns.
- C1s: sustainable nonprofits.
- C2: nonprofits that can earn 50-80% revenues.
- C3s: nonprofits providing public goods that aren't earning substantial revenues.

Across the above spectrum, you have a ton of money ($4 trillion) at the top (the market-rate returns) and a lot less but still a significant amount at the bottom ($40 billion from foundations), but very little in between. And there is a lot of important, impactful innovation happening in these middle categories.

A key question for us is how do we spark, nurture and scale entire sectors for social change?

The not-for-profits in which we invest are organizations like CGAP, or a credit rating agency in India, or foreign currency hedges for exotic currencies in microfinance; each of these things plays a role in building out the entire ecosystem.

Usually B3s don't have enough capital to scale. The B3 that could become an A is what we're really excited about.

Take microfinance as an example. Microfinance is a story of institutions going from Cs to being As. We expect to see this with other sectors in impact investing as well.

Cari: What are your biggest successes from the last 5 years?

Matt: The biggest one is microfinance. Out of the roughly $500 million we've invested in our history, we've invested approximately $100 million in microfinance. Pierre also gave $100 million to Tufts for them to invest in microfinance for-profit vehicles.

Now, there's been a lot of scrutiny lately on microfinance. But the bottom line is that it's done a lot of good. The people who now have access to credit through microfinance were taking much higher interest rates from moneylenders before.

Another success is that we've helped nonprofits develop revenue models to help them become self-sustaining.

Another area is giving platforms like GlobalGiving, DonorsChoose, and Kiva. We've also given money to Ashoka, which has brought social entrepreneurship onto the stage.

Another success – and we learned this from our grantees' responses to the Center for Effective Philanthropy survey – is that many of our grantees told us that our human capital team was of equal or greater value to them than the money we were deploying. We sit on the boards of most of the groups we support; we help them with executive recruiting; we coach their executive staff on issues they face.

Paula: There are also a number of individual organizations that have demonstrated great impact and we view as success stories. For example, Bridge Academies. We initially invested as a program-related investment without market-rate returns; since then they have grown tremendously and taken several rounds of follow-on funding. They're providing great education for children at $4 per student per month.

Elie: There's been a lot of debate about the social returns for microfinance. In particular, recent randomized controlled trials (RCTs) don't show evidence of large impacts on clients' standard of living. What are your thoughts?

Matt: Initially, the pendulum was too far on the side of the pro-microfinance hype, but now it's gone too far on the other direction. The problem with the RCTs is that you can't just track families for 2 years and expect to see big impacts from a $50 loan.

A positive impact of microfinance is that it's lowered the interest rate for people. Sure, the 40% borrowers are paying for microfinance loans are high, but it's low compared to the 300% they were paying before.

The overall impact of microfinance has unquestionably been positive. It has absolutely been a great tool. It provides individuals with choices, and in many cases it takes people from abject poverty to a place where they're better off.

People have focused on the issues in India, issues with mission drift among institutions, and under-regulation in the sector. People haven't talked as much about the politics of serving the underserved. Some groups in India had incentives to make problems for microfinance.

Cari: What are the most important things you've learned over the last five years? What mistakes have you made?

Matt: At Ebay, we had to make quick decisions because business opportunities wouldn't last long. Here, that time pressure shouldn't be what governs our actions. The issues we're focusing on will still be a problem in 5 years- we need to make sure we're taking the time to make good decisions. So, getting used to that different time frame was an adjustment. Also for me, the learning curve about the issues we focus on was steep. That was a personal learning of mine.

In terms of things I'd do differently, when I came in 5 years ago, were only doing As and Cs, and it took us awhile to consider those middle opportunities. We could have done that more quickly.

In terms of mistakes, we've been more diffuse than we should've been. We could've changed tracks earlier. Plain-vanilla microcredit became saturated, and we probably could have moved out of it sooner. We could've pushed more on sharing what we've learned. We've also been too quiet about all the things we've learned.

Some of this is just organic evolution.

Cari: Do you feel like you have more opportunities than money or vice versa? I.e., is lack of money a bottleneck to investing in more opportunities?

Matt: What we invest in is really constrained by the people we can bring in to go after all the deals we have. We're deal constrained right now with not enough B2s and B3s. Funding isn't the constraint.

The pipeline constraint is who we're hiring and figuring our how to unlock those constraints. We never think, "Oh if we only had more capital to deploy."

Cari: I feel like I'm in the place you described Pierre as being at earlier on at ON. I know about the As and Cs, but I don't feel comfortable with the middle ground.

Todor: There's no easy answer. You're doing the right things. Talk to people. Try to get comfortable with a level of ambiguity. We'd be happy to discuss some of our specific investments with you so you can learn from them.

Will: Pierre used to say that double bottom line might be a sloppy business model. We were doing straightforward investing and we were doing grantmaking. We know where you're coming from because it took time to get comfortable with that middle ground.

Todor: One example of an investment we think is great is Bridge Academies. They're providing private schools in Kenya at a cost of $4/month paid by the kids. They've done rigorous studies on academic outcomes and it shows strong effects on literacy but not on math.

Elie: Without random assignment it's difficult to address problems such as selection bias. How do you think about whether these effects are attributable to Bridge?

Todor: It's a relevant question. You can do a statistical analysis. Bridge and the public schools in the area are drawing from the same people, so we think the conclusion that Bridge is causing the impact is reasonable.

Tie: We don't test for attribution on all of our grants. Randomized controlled trial would take tremendous amounts of resources and time.

Paula: We choose to invest in companies where we believe impact is baked into the product. So if revenues are going, we see that as a sign that impact is growing. There might be selection bias here, but parents in the areas Bridge services now have another great option and they're choosing it for their children.

Tie: Is Bridge creating value? The answer is yes.

Cari: How do you know if you're failing? How would you know if Bridge isn't good?

Todor: It's going to take time. The only way we'll really know if this succeeds is when the program is licensed everywhere and it's spreading all over the world.

Tie: A while ago, we'd give "multiyear" grants but actually cut the check all at once. We set some milestones for each year, but because we had given the money, those milestones weren't as powerful as incentives for positive performance. Then, we realized that we could be more helpful if we took a governance role in our investee organizations, much like venture capitalists do. We have a board seat in a majority of the nonprofits we support. We try to agree on 3-5 metrics, sometimes 7 and we reset the milestones every year. In this way we try to work with the investee to have a collaborative vision of what success looks like, which we can do our best to support them in making happen.