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Social Return on Investment: Standard Guidelines

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SOCIAL RETURN ON INVESTMENT: STANDARD GUIDELINES

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Abstract:

This paper presents ten standard guidelines for social return on investment (SROI) -- quantitative summaries of companies' social and environmental impacts, actual or projected. The authors contend that the absence of standards for such assessments has resulted in efforts to estimate companies' environmental and social impacts that are not comparable or reliable, and are thus of limited use to those who seek to more completely understand the impact of business on society and the environment. Using data and examples from 88 real business plans, we discuss common errors in such assessments and recommendations for standardization. Using these standard guidelines would make SROI metrics more comprehensive, credible, and useful for entrepreneurs, managers and analysts to use to maximize positive social and environmental impact alongside financial returns. It would also increase the adoption of this framework by investors to compare the social impact of different companies within industries.

The authors are two of the co-founders of the National Social Venture Competition.

We thank Cathy Clark, Jed Emerson, Will Rosenzweig and Sanjay Wagle for their contributions to our thinking.

I. Introduction

Managers today run their businesses without full information about the impact of their operations on the environment and human well-being, and thus without the ability to optimize these impacts while achieving the financial returns shareholders expect. Since the early nineties, a number of guidelines and reporting standards have been advanced that are suited to the scale and complexity of corporate activity. But no framework for quantifying the value of business' impact on people and the environment has yet been articulated that informs practical management decisions throughout a company's life cycle from launch forward.¹

The basic purpose of accounting is to facilitate sound business management by quantifying the creation of value by firms. However, managers and investors concerned with sound management of firms' social and environmental impacts will be frustrated in their efforts to use financial accounting for management of these activities, since standard accounting does not address them. Environmental and social performance figure in conventional financial statements in only a few high profile exceptions, such as when exceedingly poor environmental or social practices are brought to light and diminish sales, share price and goodwill. In such cases these financial metrics serve as weak lagging indicators that a different management approach would have resulted in less damage to both shareholder value and the public's well-being. These examples point to the fact that a market imperfection exists that can only be addressed if managers can identify, interpret and act upon environmental and social impact information.

Conventional wisdom dictates that financial and social goals are in opposition: economic development versus environmental protection has been framed as a zero sum game in the United States for decades. The real opportunity, however, is the "blended value" model articulated by Emerson² in which companies achieve both economic success and maximize social benefits.

If positive and negative externalities (social and environmental impacts) resulting from company operations were quantified, with metrics that were tracked over time and used to compare impacts across companies, entrepreneurs, managers and investors could design, manage and fund companies to maximize *both* financial and social returns³. Companies that realize this vision must have a social accounting system to augment conventional accounting if they are to measure and manage the full spectrum of value they create.

To date, the effort to develop a practical, comprehensive system to assess the social impacts of business has focused primarily on large corporations and environmental performance management. We found no documented studies of companies that from launch attempted to integrate rigorous, systematic social and environmental impact tracking into their management accounting systems, although there are examples of ventures and investors who have used SROI analyses to facilitate due diligence, performance evaluation, and management goal-setting. These include a number of private equity funds, loan funds, and companies in their first six years of operations who have used SROI to quantify and value ventures' social and environmental impact⁴.

¹ [The nonprofit sector's concurrent increased focus on quantified outcomes measurement has contributed to the development of Social Return on Investment analysis. However, even the nonprofit sector still lacks a standardized framework for outcomes measurement or social accounting despite the fact that its existence is defined by its social value.](#)

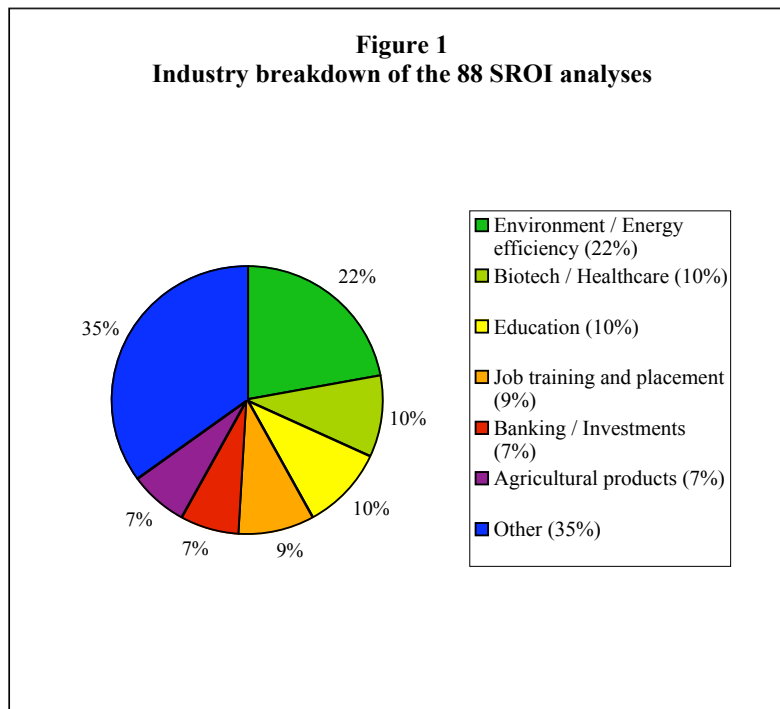
² Jed Emerson, "The Nature of Returns: A Social Capital Markets Inquiry into Elements of Investment and the Blended Value Proposition," Social Enterprise Series, No. 17, Harvard Business School, Boston, MA: 2000. [Similar arguments, particularly about the financial rewards of environmental sustainability, have been made by others such as Paul Hawken, Amory Lovins and Hunter Lovins in *Natural Capitalism* \(1999\), and Paul Hawken in *Ecology of Commerce* \(1993\).](#)

³ The term "social" is used in this paper to inclusively encompass impacts on all non-investor stakeholders including the environment, individuals, employees, communities and society – all of the non-investor stakeholders. These stakeholders may also be described as those affected by market externalities.

⁴ [For example, Mobius Technologies, a polyurethane foam recycling technology company founded in 1997, used SROI analysis along with conventional business plan projections to articulate its projected environmental and social benefits to potential investors, thereby expediting the due diligence process and identifying previously overlooked](#)

The first large set of identifiable entrepreneurs who have attempted to develop such comprehensive analyses are those who have competed since 2000 in a business plan competition for profitable businesses with a social mission, called the Global Social Venture Competition.⁵ These entrepreneurs developed quantified projections of their businesses' potential social impacts, translating the impacts into monetary values where possible. Their "social pro formas" lay out high-level performance goals from which performance metrics and data collection systems could flow logically, and together form a comprehensive social accounting framework. If taken alongside, or integrated with, financial accounting, such a framework could generate a more complete picture of a firm's total creation of value to society.

This paper presents an analysis of the patterns evident in the 88 social pro formas developed by these entrepreneurs from the years 2000-2002. All were developed for business plans by seed stage and startup companies, and represent a wide range of industries as shown in Figure 1. To address often-repeated implementation issues affecting the credibility and standardization of these social impact analyses, we have developed a quality standard against which to assess these methods and their implementation, which we call the Standard for Social Return on Investment (SSROI).



II. Definitions

Terminology is not yet standardized in the area of measuring social impact. For the purposes of this paper we would like to clarify our usage of the following terms:

Social: This refers inclusively to the entities affected by business: the environment, individuals, employees, communities and society – all of the non-investor stakeholders. These stakeholders may also be described as those affected by market externalities.

[opportunities to generate revenue. Provenex, a venture fund launched by the Rockefeller Foundation in 1999 to invest in for-profit companies whose products and/or operations advance the foundation's social mission, is currently testing SROI as a tool to evaluate the social impact of the fund.](#)

⁵ www.socialvc.net. The competition was originally called the Haas Social Venture Business Plan Competition.

Social bottom line: A term used to represent the social outcome measurement that parallels the financial bottom line. The net social benefit from business operations, with social defined as above.

Social return on investment (SROI): A term originating from return on investment (ROI) used by traditional investors. It describes the social impact of a business or nonprofit's operations in dollar terms, relative to the investment required to create that impact and exclusive of its financial return to investors.⁶

Social venture: As defined by the Global Social Venture Competition, a seed or early stage business venture that is designed to be profitable and that has an integrated social mission. The social impact of its operations is greater than the industry standard.

Sustainable: Being both economically viable and having a neutral or positive impact on the environment's ability to sustain itself indefinitely into the future, and on the health and well-being of individuals, society, and communities.

III. Context

What is the purpose of social return on investment analysis? To answer this question, we look to an example of a type of financial analysis that is routinely carried out in standard business practice: return on investment (ROI).

Financial Return on Investment (ROI) Analysis

There are two reasons companies use ROI that have particular relevance to this discussion. First, ROI is globally understood to be a relative measure of a company's success. ROIs are calculated to compare companies within a given industry to each other and to their own individual performance over time. An ROI number in a vacuum would not be a useful indicator of a company's value or of its potential future success; rather, it is a benchmark that quickly gives a sense of the company's financial situation in a relative context. For example, imagine a world in which all we knew about an investment was that its projected ROI was 50%. We would have no idea how much money we would get from the investment because the absolute value of the return is unknown— perhaps the return would be 50 cents because the investment amount was only \$1.00! Also we would not know whether a 50% return was good without knowing what other investments of similar risk would yield. If other investments yielded at least 75%, the 50% return would be a poor choice.

The second reason the ROI ratio is valuable is because it is a useful management metric. Executives manage their businesses to maximize ROI among other key metrics, knowing that ROI reflects company strength and that shareholders look to it for that evidence.

Likewise, investors and managers can use social return on investment to determine a business' performance against social and environmental criteria. SROI is a monetization of the social benefits and costs relative to the financial costs of a company's operations. It is based on the net present value of these non-market impacts in dollar terms⁷. It can be used on an ongoing basis to gauge success and inform the management of social value creation.

Social return on investment (SROI) *analysis* is the set of practices necessary to generate meaningful SROI figures and other quantified social metrics, and includes four steps:

⁶ We use this term generally, and not specifically to refer to the SROI analyses developed by the Roberts Enterprise Development Fund (www.redf.org) unless otherwise noted.

⁷ The concept of SROI as applied to nonprofits has been articulated in the REDF publication, "SROI Collection," published by the Roberts Enterprise Development Fund in 2001. http://www.redf.org/pub_sroi.htm. Guidelines for the concept's application to for-profit startups have been published on the Global Social Venture Competition website, www.socialvc.net.

- **Collection** of ongoing social performance data.
- **Prioritization** of data important enough to track.
- **Incorporation** of these data into management decision-making and reporting.
- **Valuation** to understand what amount of social value is created or destroyed, and by extension where resources should be allocated.

SROI analysis helps managers and investors accomplish three critical tasks:

- **Plan.** It helps entrepreneurs as they plan their businesses to identify business model modifications or alternatives as well as market opportunities that could result in increased social benefits.
- **Manage.** It assists management with ongoing operational management and capital allocation decisions, by helping them manage and maximize the social bottom line in tandem with the financial bottom line.
- **Assess.** It facilitates evaluation of investment opportunities and of their performance with respect to investors' specific social and financial goals.

IV. Social Return on Investment

Economists and public policy analysts have used economic models and cost-benefit or cost-effectiveness models for decades to gauge the economic impact of social programs, most often as a policy tool used to influence levels of government spending⁸. Cost-benefit analysis is typically carried out either at the outset of an investment to determine whether it is likely to generate benefits superior to the next best alternative, or retrospectively to determine whether the investment was worthwhile. Social return on investment differs from cost-benefit analysis in two critical ways. First, SROI is a practical management tool, enabling informed decision-making on a regular basis. A typical social cost-benefit analysis is not used by managers in regular business decision-making, instead it is used periodically to determine the least expensive way to provide benefits or to reduce negative impacts to all key stakeholders. Second, SROI enables managers to maximize *both* social and financial benefits. By contrast, cost-benefit analysis typically frames benefits and costs as trade-offs and does not facilitate planning or prioritizing that optimizes both financial and social value creation.

To illustrate SROI methodology in detail, we use the version employed by the Global Social Venture Competition. Steps in the calculation of SROI are below.

⁸Henry M. Levin, Cost Effectiveness, A Primer. Volume 4: New Perspectives in Evaluation. Sage Publications. Newbury Park: 1983.

Steps in the calculation of SROI

Companies from which examples are taken are: a restaurant that trains and employs formerly homeless people and provides health care to its employees, resulting in a reduction among the employees in the number of visits to the emergency room per year, among other benefits; and a polyurethane (PUR) foam recycling technology company that enables PUR foam makers to purchase fewer chemicals per year, resulting in the creation of fewer emissions in the production of those chemicals, among other benefits.

1. Quantify non-financial impact of operations per unit

Example: 10% reduction in visits to emergency room = 150 fewer visits per year;

6% reduction in CO2 emissions per year = reduction of 12,000 tons CO2.

2. Translate into dollar terms per unit to achieve “social cash flows”

Cost per ER visit \$250 x 150 ER visits no longer happening per year = \$37,500/year;

Cost per ton CO2 \$1.25 based on regional emissions trading markets x 12,000 tons reduction per year = \$15,000

3. Sum all SCFs for the horizon in question

Annual social cash flow is \$37,500 + \$15,000 = \$52,500

There is currently no standard time frame for social return on investment projections. Five years is used since projections beyond this time are so uncertain as to be meaningless, and since this is typical for financial projections among startups.

4. Discount SCFs to present value**

Discount each year’s summed social cash flows by an appropriate discount rate. Document all assumptions.

There is presently no market standard for determining the appropriate discount rate. This issue is discussed further in this paper.

<u>Year 1</u>	<u>Year 2 ...</u>	<u>Present Value of social cash flows Years 1-5</u>
$52,500/(1+.20)^5 +$	$52,500/(1+.20)^{1.5} +$	$=$ \$171,993

5. Divide by investment to date = SROI

<u>Year 0- investment</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
\$ (100,000)	\$47,926	\$39,938	\$33,282	\$27,735	\$23,112
PV of Cash Flows	\$171,933				
Investment	\$100,000				
SROI	172%				
SIRR*	25%				

*SIRR is preferred by some investors. It is the discount rate at which all cash flows including investment sum to zero.

**Any errors in PV calculations are due to rounding.

SROI is of little use in the absence of a process framework by which it may be consistently applied by a large number of companies. As with ROI, SROI alone in a vacuum would not be a useful indicator of a company's value or the potential of its future success; rather, it is a benchmark figure that gives a sense of the company's situation in a relative context. This framework will be presented here as the Standard for Social Return on Investment.

V. Standard for Social Return on Investment (SSROI) Guidelines and Discussion

The Standard for Social Return on Investment (SSROI) proposed here is the following set of ten guidelines for the calculation of SROI. Each is discussed in more detail below.

The Standard for Social Return on Investment (SSROI)

Note: While the unit of analysis of the SROI is referred to in these guidelines as "the company," these guidelines are relevant to any entity on which SROI analysis is performed (e.g. a business unit, project, or nonprofit organization).

Guideline #1: Include both positive and negative impacts in the assessment.

To draw a complete picture of the value generated by a company, known positive impacts resulting from an enterprise's operations must be accounted for, but so too must known negative social impacts. Most often, however, entrepreneurs in the sample failed to even consider the various negative impacts of their operations.

An example that illustrates the importance of this is the business plan of a paperless company that claimed as part of its potential social return the environmental benefit of reduced paper use without any discussion of the relative impact of the substitute: computers and the impact of their manufacture, operation (through energy-related pollution) and disposal. Similarly, a solar energy company gave no attention to the relative environmental impact of the manufacture, distribution and maintenance of solar panels.

Guideline 2. Consider impacts made by and on all stakeholders, including those inside the company itself, before deciding which are significant enough to be included in the assessment.⁹

Typical startup business plans contain little or no detail regarding specific internal policies and practices affecting financial performance. The majority of business plans in the sample focused on assessing the external impacts of their organization and ignored social impacts resulting from internal operations. However, since one goal of SROI analysis is to assist companies to grow while achieving greater sustainability for both internal and external stakeholders, consideration of the social impact of internal practices is important. Internal evaluation would reflect consideration of, for example, company culture and supplier relationships. It would also include assessments of activities such as energy and waste management and the corresponding effect on the environment, as well as of employee satisfaction and its effect on retention.

One firm in the study planned to produce air conditioning optimizers, machines that reduce overall energy consumption of commercial air conditioning units. In its business plan, the company did not mention that it planned to use its own air conditioning (AC) optimizer in its own facilities, or assess the cost savings that might result. Although the company would have been too small to use its product during start-up, an in-depth internal analysis through its growth might have included the use of its own AC optimizer.

This raises the question: to what level of detail should an assessment be performed? For business

⁹ For assistance prioritizing the most impactful environmental practices, see: [The Consumers's Guide to Effective Environmental Choices: Practical Advice from the Union of Concerned Scientists](#). Michael Brower and Warren Leon, Eds. Three Rivers Press, New York, New York, 1999.

planning, our advice at present is to carry the analysis to the level that makes a significant difference in the analysis, and/or that identifies practices that will have a significant impact as the business grows. Knowing that forecasts always need to be adjusted over time to match reality, an item that might change the assessment's overall result to a very small degree is probably not worth including. However, in deciding which impacts to include in the SROI projections, it is important to be forward-thinking and include even those aspects that are negligible at start-up, if they may be significant when the business has scaled up. Moving forward, the goal should be to develop assessments of sufficient detail that firms can account for all of their social and environmental impacts, with management aiming for a zero- or even positive-sum impact.

Guideline 3. Include only impacts that are clearly and directly attributable to the company's activities. Be conservative with leaps of faith, and don't take credit for more than your organization can realistically affect.

A recurring question is whether the company can actually claim responsibility for the impacts included in the analysis. The issue centers on the directness or indirectness of the effect of the company's activities.

In some assessments, entrepreneurs credited themselves with social impacts that were not the direct result of company activities. One company with a software tool to help microfinance institutions manage their loans claimed the full benefit from all of the activities of the microfinance institutions. Another consulted to companies around bioethics, and claimed the full social benefit of the products on which it consulted.

Several companies whose activities were projected to result in donations to nonprofits, or whose measured social impact was based solely on a percentage of company profits allocated for charity. These companies claimed the dollar figure of these funds without considering the social impact of those funds once they were donated. This is a seriously mistaken assumption, though common. Unfortunately, simply increasing money flow into nonprofits does not guarantee a positive social impact.

Guideline #4: Avoid double counting the value (financial and social) created by the company, and do not use market valuations of social impacts where they do not reflect full costs and benefits.

Companies following the NSVC guidelines were asked to prepare both financial and quantified social impact projections. This resulted in some double counting: some companies meant to quantify their social return on investment, but counted their financial impact instead. For example, one company used revenue generated from the recovery of waste gas as a measure of its social impact, rather than quantifying the environmental value gained. Here, good old-fashioned financial returns were confused with the public benefits of an incrementally cleaner environment.

In another example, a coffee producer counted the value of its sustainable farming practices to be the \$0.50 per bag of coffee that consumers were willing to pay for their sustainably-grown coffee. Measuring the social impact by the market value of the perceived benefit, called contingent valuation, works only if the market is good at valuing all of the externalities that affect all relevant stakeholders. Making this distinction can be tricky, but it is critical: **the essential rationale for calculating SROI separately from financial returns is because the market's valuation of social benefits is imperfect. In cases where it is perfect, there would be no need for an SROI analysis.**

However, there is a difficulty in determining a comprehensive, valid, reliable value for a given impact when there is no market-based price for it. Over time one of the great potentials of the widespread use of high-quality, standardized SROIs is that market prices could begin to reflect the true value and cost of social impacts, or that proxy markets for units of social impact could be established enabling companies to capture their social value creation. It is left to the interested parties to determine whether a dollar value derived from market prices is sufficiently inclusive of the full value or cost of a social impact. In cases where it is not, a social impact valuation must factor the full dollar cost or value to society of the impact in question. When even this is incomplete, the monetary social impact value must be accompanied by a discussion of the value inherent in a given impact that is not monetizable or even

quantifiable.

Guideline 5. In industries or geographic areas in which impacts would be created by the existence of any business, these impacts should not be counted in an SROI. The SROI should describe what makes the company different from a standard venture in the industry or region (i.e. from its competition).

In the same way financial analysts need to understand a company's competition to truly understand the context of financial performance numbers, **understanding a company's social impact requires comparing businesses' social performance to the next best alternative.** As previously mentioned, there are some industries with very clear social benefits built right into the product or service - for example, health care or energy-efficient products. When socially-aware investors concerned with financial and social returns make decisions about investments in such industries, they still need to be able to judge as given company's social performance relative to others. Similarly, for managers to know if they really are making progress and maximizing their potential positive social impact, they need to know how they are performing relative to their industry peers.

Take the case of a drug company that improves people's medical health through the sales of its drug. Given that the company's financial success depends upon the company creating the social benefit of improved health, is it fair to claim these benefits as the company's social impact? We think that merely knowing that a benefit is created is not sufficient to inform an investment decision: even a healthcare company must strive to make its social impact greater than its peers' before it can claim to have a large SROI.

In a similar vein, there are situations in which *any* company in a particular region would have comparable social benefits. Consider a company that locates in a developing country and claims economic development benefits. In regions where there is little economic activity of any kind, the presence of any company offering jobs may represent a significant step forward in the quality of life for community members. But if the business is no more socially and environmentally responsible than other companies in the region, how does one judge social impact? In such a case, including these benefits would be reasonable, as long as both economic, social and environmental impacts on communities are included. In well-established industries in thriving economies, on the other hand, the context dictates that social impact must outstrip that of peer firms. In between lies a gray area, which is why continually raising the social performance bar is essential to meaningful impact assessment: a paying job is better than no job, a living wage job is better than a subsistence wage job, and so on.

The quantitative analysis of a company's impact should always begin from a theoretical ideal of zero negative impact, but information on how the company's performance compares with the next best alternative in its marketplace must be provided to give the SROI context and meaning. It is virtually impossible for any company in the present market context to be perfectly free of any negative impacts. The question is: in which direction are we heading? When properly calculated, SROI reflects the relative improvements in well-being a business delivers over the status quo, and thereby becomes useful as a management and analytical tool. If we value companies' marginal improvements in social impact relative to their peers and base capital allocation and investment decision on these valuations, over time, market forces will drive industries toward sustainability.

Guideline 6. Only quantify or monetize impacts if it is logical given the context of the impact, business or industry.

As previously mentioned, we do not believe that a quantified social return on investment alone, even one that avoids some of the problems outlined in these guidelines, is enough to provide investors and managers with an accurate assessment of the social performance of a company. Quantification enables the analyst to deduce complex information into data that can easily be compared and valued. At the same time it may be difficult or misleading to summarize all impacts in one number. To overcome this, one business plan describing a solar energy technology for use in developing countries identified multiple metrics to explain the company's impact, from electricity savings to increased quality of life to

projected lives saved due to reduced harmful pollutants. Not all of these impacts (such as increased quality of life) could be accurately monetized, and some (such as lives saved) could not be meaningfully reduced to monetary terms alone.

When monetization is appropriate, one common technique is to use comparison costs, or how much money it would cost to create the same benefit. For example, one plan measured the value of increased voter turnout by the cost to register additional voters. Another intriguing technique was to estimate the value of some benefits by analyzing what one would pay for a guarantee of that benefit, a technique that factors risk into the valuation of the specific benefits.¹⁰ Users of both techniques should avoid confusing these approaches with the market's valuation of the benefit, which, as discussed above, is not presently based on impacts on all relevant stakeholders and so is not an accurate reflection of the public cost or benefit.

The authors encourage companies to test and identify metrics that work best for their particular industries. As the practice and methodologies of social return on investment progress, it may be possible to standardize some measurements in the same way financial reporting has been standardized over the centuries.

Guideline #7: Put numeric metrics into context (e.g. this period versus last period, this company versus similar companies) to give the social return on investment meaning.

As a widely-used introductory financial accounting textbook states:

“[R]atios, by themselves out of context, provide little information. For example, does a rate of return on common shareholders' equity of 81.6 percent indicate satisfactory performance? After calculating the ratios, the analyst must compare them with some standard. The following list provides several possible standards for comparison:

1. The planned ratio for the period.
2. The corresponding ratio during the preceding period for the same firm.
3. The corresponding ratio of a similar firm in the same industry
4. The average ratio for other firms in the same industry.”¹¹

In the same way, the SROI ratio itself, which ultimately coalesces the company's social performance into a single figure, cannot possibly tell the whole story of the company's social impact without a well-understood context.

Guideline #8: Address risk factors affecting the SROI in the assumptions, and carefully consider and document the choice of discount rate for social cash flows.

The choice of discount rate can dramatically change the result of a quantified social return on investment. Following REDF's lead, many entrants used the municipal bond rate (ranging from 4.3 – 5.0%); other entrants used the 30-year Treasury bond rate, making the argument that they were saving federal and other governmental funds through their activities. Some of the discount rates with sound supporting arguments were based upon the cost of capital, while others were based upon estimates of the risk inherent in realizing the social impact.

One business, a healthcare management software firm called Cask Solutions, presented a particularly well-conceived rationale for its chosen discount rates.

¹⁰ A topic worthy of further exploration is the relationship between [social return on investment and](#) actuarial analytical models and tables, which enable actuaries to assign prices to such things as snowfall, lives and body parts; [and Social Return on Investment](#).

¹¹ Stickney & Weil. 1997. Financial Accounting: An Introduction to Concepts, Methods and Uses, Eighth Edition. Forth Worth: Dryden Press.

"A larger discount rate generally implies a larger risk. From the perspective of Cask Solutions, we evaluated how risky our expected social returns would be relative to our financial returns. We recognize that calculating a social benefit is reliant on many assumptions. This process thus broadens the 'band' within which we expect the real social return to fall, and a higher discount rate would be appropriate to reflect the risk associated with the fact that some social benefits may not accrue as expected. Furthermore, because the social benefits are believed to be tightly linked with the use of Cask Solutions' products, we would expect that the risk of achieving our social benefits should be in line with the risk of the enterprise returns, suggesting the use of a discount rate similar to our enterprise discount rate [which was calculated using comparables at 18.9%]. We have evaluated all these options in a sensitivity analysis, and believe that 25% is the best rate to use, reflecting the most realistic assessment of risk.¹²"

Cask's rationale was accompanied by a sensitivity analysis showing the social returns resulting from the application of discount rates ranging from 3% to 30%.

The area of discount rates for quantifying monetized social returns is one that needs further research and study to enable as rigorous a selection of discount rate as can be done for financial valuations. At present, we believe the best solution to the question of discount rate is to use one that reflects the uncertainty of the projections of the company's financial success and effectiveness achieving its social impacts, and includes consideration of the time required before social impacts are evident.

Guideline #9: Carry out a sensitivity analysis to identify key factors influencing projected outcomes.

Only nine percent of the assessments in the study provided a sensitivity analysis to test what effect different assumptions had on the projected SROI figure. This would be useful in understanding both the analysis and the likely social impact. Given the current lack of standards in measuring social impact, having a sense of both the range of possible impacts, and how dependent they are on key assumptions, is important.

Guideline #10: Include ongoing tracking of social impact.

A key problem uncovered in the review of the plans is the lack of integration of the SROI into business operations. Among the few plans that included ongoing impact tracking, the most common method was an annual social audit to be presented to the board. Without more details on how the audit criteria were to be developed or what standard would be used, it is hard to determine the usefulness of this approach. Many of the impacts that would need to be tracked would require that a system be in place that captures more data than those already tracked for financial accounting purposes. We refer for example to the OASIS methodology, the Balanced Scorecard and other ongoing performance management practices (see Appendix B).

Cost accounting

Since this principle is basic to financial accounting, we do not include it as a guideline in the SSROI. Nonetheless, it is an important concept that should be kept in mind when performing SROI Analysis.

Many assessments in the sample arrived at a monetized social benefit figure by taking the total social benefits over the total time horizon and subtracting a lump sum defined as the "social cost." In most cases, this "social cost" was actually the financial expense to the company of generating the social

¹² Katherine Kim-, "Cask Solutions, Inc. Business Plan." 2002.

benefit, not the negative social impacts. This calculation mixes apples and oranges. The correct calculation is modeled after the Return on Investment or Return on Assets. It should be done on an annual basis subtracting the negative social impacts from the positive social impacts. To compare the net social outcome to the investment or asset base, the financial expense figure can be used to calculate a social return on investment (SROI) or social internal rate of return (SIRR), or an asset figure could be used to calculate a social return on assets (SROA).

To sum, social return on investment analysts should base their numbers on sound data, accurately represent the certainty of claims, and have a plan for continuous collection and management of social impact data. They should consider all significant impacts and make only reasonable claims of causality. This will make SROI useful to managers and investors, help them see where their understanding of their impacts is weak, and encourage them to plan ahead to optimize social impact into the future.

VI. Issues and Limitations of Social Return on Investment

Even when the SSROI is followed, several issues need to be considered when interpreting the results of an SROI analysis.

Social impact can be a personal or political measurement

Social return on investment analyses often involve subjective value judgments regarding the measured outcomes. For SROI to make any sense as a tool by which to judge businesses, it must be considered within the political environment and the personal goals of the entity performing the analysis. Consider the case of a biotechnology firm that produces an AIDS prevention salve for use domestically by upper-income women, but which is also distributed to subsistence farmers in the developing world. The issues, such how much weight to give each group when the SROI monetization reflects lifetime earnings potentials that are far greater in the U.S. than in the developing world, reflects the goals of the investor or management as much as the facts. If the tool is being used within a private organization, the foundation or firm can address this by clearly outlining its desired social goals. But if the goal is a broader, such as the creation of multiple cap-and-trade schemes for units of social value,¹³ tough collective decisions will need to be made about what define positive and negative impacts.

Quantification

In the absence of consistent standards, many factors must be considered to determine what social outcomes are appropriate for use in an SROI.¹⁴ First, there are issues of data quality and availability:

- **Measurement.** Appropriate data and research linking business outcomes to quantified social impacts may not be available.
- **Causality and Correlation.** There may not be a strong correlation between business outcomes and a monetizable economic return to society.
- **Timeframe.** When the impacts of a business lead far into the future, there is often uncertainty whether long-term benefits will actually be realized, and if so whether they are the result of earlier activities.

Second, as has been discussed above, SROI should not be used to compare two or more different businesses, or business in different industries, unless the method used to generate the analysis was consistent. Differences in outcomes measured, measurement methods, and data sets used can

¹³ [Emerson and Wachowicz \(1999\) have written about a conceptual nonprofit stock market.](#)

¹⁴ Much of this discussion is adapted from an unpublished paper: Lindl, Lingane, Walters. "Social Return on Investment: A Practitioner's Perspective," 2000. These issues have also been discussed in the self-published REDF SROI Collection, including by Cynthia Gair, 2002, "A Report from the Good Ship SROI." http://www.redf.org/pub_sroi.htm#overview.

significantly affect the SROI calculation, and, if not standardized, could result in comparisons that are of little value.

Third, when using SROI to compare two seemingly similar organizations, the different starting points of those organizations relative to the achieved social outcomes should be considered. Take the example of two businesses that serve as job training programs for “at risk” populations. Employing one population versus another may inherently be more difficult or costly given the organizations’ different missions (imagine two youth programs, one for high school college track students and the other for homeless teenagers). If the metric of success of both programs is the percentage who find gainful employment outside their enterprises, the success of the organization that trains high school students may appear to be higher, resulting in a higher SROI valuation. The greater difficulty of serving homeless youth needs to be factored into the analysis in the valuation or made clear so that investors can make informed decisions.

Absence of data from large numbers of companies

If sufficient numbers of enterprises with similar social outcomes were to develop SROI analyses we could begin to determine whether developing difficulty coefficients and other such variables would be of practical use. But in the absence of social impact data from a large number of companies to enable industry comparisons, those seeking full context for their SROI will be frustrated.

Today, the process of developing such an analysis is valuable as a means of catalyzing opportunity recognition and of aligning investor-investee expectations that are so critical to the success of an early stage investment. Having a preliminary understanding of specific social impacts is a vast improvement over having only a general idea that positive impact may be taking place. Only if sufficient numbers of enterprises working to achieve similar outcomes with similar populations develop SROI analyses will the appropriate difficulty coefficient and other variables begin to come to light.

One of many measures of success

It can not be stressed enough that SROI cannot and should not be used as the sole indicator of social performance, in the same way that ROI is not used as a sole indicator of financial performance. Instead, as with financial metrics, having both additional quantified outcome measures and a qualitative and narrative descriptions (as in a standard annual report) is the only way to gain a more complete understanding of a business’ social impact.

VIII. Conclusion: the Opportunities and Challenges of Social Return on Investment

This study is based on projected, not actual, assessments of social impact. To determine the true value of SROI it will be necessary for companies to collect the data necessary to create SROI analyses based on their actual performance. However, this study clearly indicates that the process of calculating an SROI, actual or projected, can help companies identify opportunities to create social and increased financial value. As a result of its analysis, one packaging technology company that used molded fiber as its feedstock and was primarily environmental in focus realized that the majority of its positive quantifiable social impact stemmed from its “Township Model” of employing low-skill workers at small-scale factories in urban industrial centers. Other companies had insights about which markets to enter first to generate the largest financial *and* social impacts, whereas in the absence of the social consideration they would have chosen a different route, thereby achieving similar financial returns but failing to generate substantial social impact: in other words, generating financial returns at a “social opportunity cost.”

It is the prevailing assumption in business that opportunities to create social benefits detract from financial performance. The pressure to demonstrate positive social outcomes (or minimal negative ones) unfortunately does not really exist today, except in limited social investment circles. As a result, most entrepreneurs and investors do not perform any sort of SROI. Entrepreneurs’ time and financial constraints are typically severe, and in practical terms they are unlikely to spend time on such assessments unless it is seen as important to their potential investors.

But the reality is that a reasonably thorough projection of social impact is not prohibitively

expensive even for early stage companies. The price of a projected SROI like those in this study ranges from zero to a few thousand dollars. Some benefits may result from analysis of projected SROI even without ongoing tracking efforts.

The quality and consistency of implementation of the analyses, however, is critical to their value to companies, investors and the public. We hope that the Standard for Social Return on Investment presented here will advance the efforts of investors, managers and analysts to account for companies' true performance in a reliable, credible manner. These accounts should be made publicly available to inform the general public of companies' social performance, and to enable industry-wide analyses.

This will only happen if the sources of capital require it.

We therefore call upon investors to require SROI of all their investees, and to ensure these assessments are implemented according to uniform standards such as the SSROI proposed herein. Further, we call for investors to maintain ongoing records of the actual social performance of their investments, and make these available to outside analysts. This will result in a body of data whose analysis will provide important insights into how social value is actually created (or destroyed), and what it really costs. Until then, business will continue to operate in the dark, missing opportunities to advance all of our interests, public and private.

Appendix A. Overview of the Global Social Venture Competition

The Global Social Venture Competition (GSVC) is a business plan competition for profitable startups with an integrated social or environmental mission (www.socialvc.net). Originally called the Haas Social Venture Business Plan Competition, it was started in fall of 1999 by five MBA students at the Haas School of Business at U.C. Berkeley. GSVC partnered with the Goldman Sachs Foundation and Columbia Business School in 2001, and with London Business School in summer of 2003.

The GSVC is run very much like a traditional business plan competition. Its judges typically include experienced investors and entrepreneurs from both traditional and socially- or environmentally-oriented backgrounds. A smaller number of nonprofit and foundation leaders have represented the philanthropic “investment” perspective.

What makes the GSVC unique are the defining social venture criteria it demands of entrants. They are:

- **Core Mission.** Each entrant’s business must have at the core of its mission and operations a social or environmental purpose.
- **Self Sufficiency.** Plans may be for-profit businesses or businesses owned by nonprofits; however, regardless of tax status, the plans must be at least self-sustaining through revenue generation or profitable
- **Quantified Social Impact Assessment.** In addition to the traditional financial statements, an analysis of the business’ or organization’s social impact is required. This must include a quantitative summary of impact.
- **Industry Standard.** Plans’ social impact must be an improvement over the industry standard.

The competition founders established these criteria based on three beliefs about the nature of business: that business can be sustainable; that for business to be sustainable it is necessary to understand and manage the costs and benefits of operations on people and the planet as well as on the bottom line; and that understanding costs and benefits requires tracking them systematically. The stipulations were intended to assist judges and entrants in understanding how to present and assess information about the relative merits of the entrants’ ventures.

THE VISION OF THE GLOBAL SOCIAL VENTURE COMPETITION

The vision, mission and objective of the competition have remained constant as the competition itself has expanded in scope and reach through international partnerships.

VISION

Change the way business measures success

We envision a world in which business measures success by evaluating social, environmental and financial returns on investment. Doing so will help build enduring organizations that create value for future generations.

MISSION

Catalyze and promote the creation of profitable social ventures

We seek to inspire business school students and their business partners to create social ventures—enterprises that are financially sustainable or profitable and have a quantifiable social or environmental goal incorporated into their mission.

OBJECTIVE

Create a national forum for entrepreneurs

We will organize and host a social venture business plan competition that provides a national forum for entrepreneurs to showcase their plans and for investors to support groundbreaking social ventures.

Appendix B: Examples of Valuation and Management Process Methodologies

Valuation Methods

The following methods are typically used for snapshot social “valuations” by investors and business or nonprofit managers, and come primarily from non-profit social ventures, government organizations, and socially-oriented investors. A point worth noting is that methods that address social values are rooted in cost-benefit analysis, and as such remain separate from attempts to assess the inherent or moral “value” or worth of a given enterprise.

AtKisson Compass Assessment for Investors. Evaluates social and environmental impacts in four comprehensive areas derived from corporate social accountability standards plus a fifth area called “Synergy” between these areas, and assigns a numeric rating to the venture’s performance in each area. AtKisson regularly updates its methodology. www.atkisson.com.

Global Social Venture Competition SROI. Blends the IFC and REDF models in a five-step approach (outlined in Figure 1 above). Entrants to this business plan competition use the method to project the social impact of their startups. www.socialvc.net.

Roberts Enterprise Development Fund’s Social Return on Investment (SROI) Framework. – Particularly geared toward nonprofits running businesses that hire and train populations with above average unemployment and below average job success. Facilitates evaluative or projective estimation of the incremental social benefit of the enterprise, and is primarily useful for an investor or funder seeking a summary of an investment’s social impact. www.redf.org.

World Bank’s Economic Rate of Return (ERR). Based on a benefit-cost framework, it entails a monetized assessment of a given project in comparison to its next best alternative. www.ifc.org.

Management Processes

Methods that focus on the ongoing process of performance monitoring have emerged from the corporate social accountability and corporate strategy disciplines. These include the following.

Balanced Scorecard. Creates ongoing internal benchmarks for four major areas of importance to a venture’s success with the goal of balancing financial interests with other organizational and constituent goals. www.bscol.com.

REDF OASIS. Management information systems (MIS) customized to the data tracking needs of specific nonprofits, used to aid in the management of the overall nonprofit as well as its social enterprises. www.redf.org.