

# BUILDING A SOCIAL CAPITAL MARKET IN ISRAEL

FINANCIAL INNOVATIONS LAB® REPORT



MILKEN INSTITUTE

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## FINANCIAL INNOVATIONS LAB® REPORT

Financial Innovations Labs bring together researchers, policymakers, and business, financial, and professional practitioners to create market-based solutions to business and public policy challenges. Using real and simulated case studies, participants consider and design alternative capital structures and then apply appropriate financial technologies to them.

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## ACKNOWLEDGMENTS

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## ABOUT THE MILKEN INSTITUTE

A nonprofit, nonpartisan economic think tank, the Milken Institute believes in the power of finance to shape the future. The Milken Institute produces rigorous, independent economic research—and maximizes its impact by convening global leaders from the worlds of business, finance, policy, academia, and philanthropy. By fostering collaboration between the public and private sectors, we transform great ideas into action.

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## COVER PHOTO

A demonstration in Jerusalem in August 2011 was part of a nationwide bipartisan protest on social-justice issues that addressed inequality and social and regional gaps in the Israeli economy. These included cost-of-living increases, early-childhood education, affordable housing, health costs, and economic concentration, as well as social investment, which was addressed at the Financial Innovations Lab summarized in this report.

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Israel needs a large and efficient  
sustainable third sector.

—Eugene Kandel, National Economic Council



## Introduction

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During the industry deregulation and tax liberalization of the early 1990s, Israel became home to one of the world's largest concentrations of venture capital, and launched itself as the “startup nation.” The success of its information technology revolution, fired by a “find the problem, solve it” entrepreneurial spirit, spilled across all major sectors, leading to the country's economic miracle.

But Israel is not immune to the effects of the global economic crisis. In today's climate of economic uncertainty, both the public and private sectors are facing tough decisions as budgets shrink and financial stability falters; meanwhile, government and industry must function to meet growing demands for education services, infrastructure development, housing costs, and investment in new ideas. Once again, the country's resilience is tested as new appeals are made to find entrepreneurial solutions to social problems.

Need may drive new financial innovations in the arena of social investing, where the bottom line includes both financial and social returns. Just as Israel's water shortage led to advances to treatment and recycling technologies for the benefit of the nation, recent economic austerity may produce new policies and financial products to provide long-term sustainable support for the social sector.

For the purposes of this Lab report, a country's “social sector” is defined as a mix of both public (government) and private (philanthropy, financial institutions, businesses) entities working together to target social and economic development issues, such as public health, education, the environment, and resource productivity. In many countries, but not yet in Israel, the social sectors are employing a relatively new tool called social investing—impact investing or double bottom line investing—that blends public and private capital for financial and social returns.

The institutions and individuals who engage in social investing hope to see lasting socioeconomic and/or environmental impacts; they are in a real sense investing with a mission. Social, or impact, investors vary in size (from small funds to large institutions), sector (private capital, or public and philanthropic agencies), and approach (private ownership or private-public partnerships). But they all recognize that well-structured investments and financial vehicles can produce benefits beyond financial returns, and that investors and society alike are better off when investment decisions include these multiple factors.

In late 2011, the government initiated the implementation of reforms designed to address areas of social weakness and declining investment in government services, charging almost every government ministry to carry out its mandate.<sup>1</sup> In May 2012, the National Economic Council and leaders in Israeli, U.S., and U.K. social investing markets participated in a Milken Institute Financial Innovations Lab intended to help prepare the roadmap for creation of a social investing “environment,” e.g., looking at appropriate policy reforms and financial instruments.

The Lab focused on the conditions, context, and prospects for social investing, and the operational mechanisms for an Israeli social capital market system. Creating innovative platforms for social investing would help solve longstanding problems and could establish Israel as a center of this important financial innovation. The Lab focused primarily on how to structure social investment funds but also considered the expanding role of financial institutions to leverage capital and explored the use of pay-for-performance contracts (e.g., social impact bonds).



## Issues and Perspectives

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Israel's social sector—the public and private agencies, institutions, and businesses that address the country's social and economic development—plays a vital part in the economy, identifying and dispensing public and social services to the population. The sector comprises approximately 15,000 active organizations employing almost half a million workers.<sup>2</sup> Unfortunately, their funding is fragmented, sporadic, short-term, and often insufficient to provide competitive, efficient services to meet the social needs. Their operating models tend to be service-oriented, measuring outputs rather than outcomes, and they are unable to leverage the value they create. The government itself lacks important tools and policies that could lead to an expansion of capital resources available to social enterprise.

Spending by Israel's social sector represents 5.6 percent of GDP, among the highest in the developed world; the sector employs about 15 percent of the labor force. The sector's revenue base is divided among philanthropy, government, and fees for services. On a net cash-flow basis, Israeli NGOs, which constitute most of Israel's social sector, ran operating deficits estimated at 1.6 percent in 2011.<sup>3</sup> While these operating losses are requiring more government funding, the projected 2013 budget deficit for the government may exceed 3.5 percent of GDP.<sup>4</sup> Such grim numbers have caused many organizations to cut back or shutter operations. At the same time, growing at-risk populations, declining school achievement, and distressed communities all need increased social services. The public has called for additional resources to deal with these challenges, and for new business models of finance and delivery.

Social investing, as noted, is an approach to finance that expands returns to include social benefits. Philanthropic funds, corporations, and individuals engage in social investing in a variety of the forms, including direct investments like loans and equity investments; credit enhancements, such as guarantees or insurances; and even supplier or customer financing, such as long-term public service contracts. This kind of investing fills a gap between public and private sources of financing and funding, especially where private companies do not (or cannot) provide services competitively, usually because returns are not matched to risks, and where public and nonprofits are not sufficiently flexible or incentivized to take risks.

Similarly, the social enterprises in which these groups invest fill the gap between public and private enterprise. These include welfare and community organizations, arts and cultural organizations, and even health care, alternative energy companies, certain kinds of schools, and housing.<sup>5</sup> Their legal forms have evolved to include both not-for-profit and profit-based enterprises. When private-sector capital is leveraged with public incentives and investment, the returns are able to reach a higher level.

Figure 1 shows a spectrum of services provided by various types of organizations, ranging from public to private enterprises.



FIGURE  
1

*Organization forms and features, based on adjustments for risk and returns*

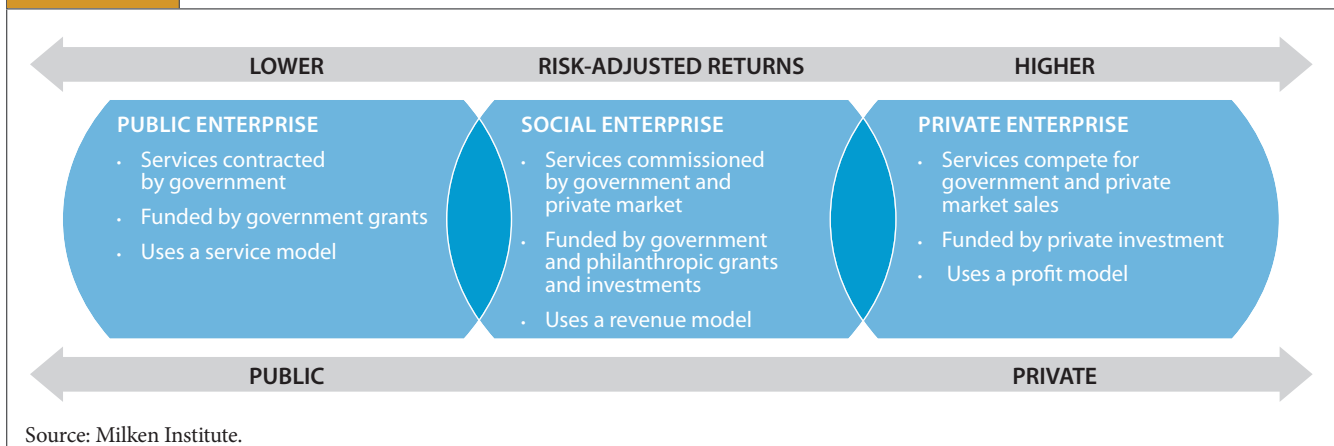


TABLE  
1

*Legal forms, requirements, organization, and tax structure of social enterprise*

Legal form	Purpose, description, requirements, and tax treatments
Nonprofit associations	<ul style="list-style-type: none"> <li>The primary purpose is not to generate profits. The core activity is not business-oriented.</li> <li>No generation or distribution of profit, directly or indirectly, is permitted.</li> <li>A board of unpaid directors governs the nonprofit. Board members are paid only a stipend for attending meetings.</li> <li>The association is exempt from corporate taxes but must pay salary taxes; it may sell services without charging a value-added tax (VAT); it must pay the VAT on revenues.*</li> <li>It must pay dividend taxes on profits from any subsidiary.</li> </ul>
Corporation for public benefit**	<ul style="list-style-type: none"> <li>No distributions, including dividends, are allowed.</li> <li>Bylaws define public objectives only as they bar the distribution of profits or other distributions to its shareholders.</li> <li>Shareholders have limited ownership of the enterprise or of their shares, which they cannot sell or transfer. Board members are paid only a stipend for attending meetings.</li> <li>The association is exempt from corporate taxes but must pay salary taxes; it may sell services without charging a value-added tax (VAT); it must pay the VAT on revenues.*</li> <li>It must pay dividend taxes on profits from any subsidiary.</li> </ul>
Corporations or partnerships	<ul style="list-style-type: none"> <li>Corporations and partnerships operate according to business considerations for the purpose of maximizing profits.</li> <li>They are permitted to distribute dividends, transfer ownership, and issue shares with all methods of financing, including secured and non-secured debt.</li> <li>Directors may receive all forms of payment and compensation.</li> <li>Dividends to shareholders are subject to corporate taxes and VAT on purchases and sales.</li> <li>They may depreciate their assets, claiming a portion of the "lost" value against taxable income.</li> <li>Directors are allowed, within their business judgment, to take into account the interests of its creditors, employees, and the public at large, among other things. Likewise, a company is allowed to donate a reasonable sum to a worthy cause.</li> <li>They do not pay dividend taxes on profits from subsidiaries.</li> </ul>

Source: Yaron Keidar, Milken Institute.

\* See discussion about the registration and tax requirements for various forms of organizations in Appendix B

\*\* See Section 345a(a) of the Israeli Companies Law 5769-1999

The different and still-evolving legal structures of business and social enterprises require broad, inclusive, and flexible approaches to investing, and a clear understanding of the balance between risks and rewards, and between public and private benefits. To better understand the current and potential environment in Israel, including the barriers to expansion, Lab participants reviewed the challenges facing the various stakeholders, as well as the hurdles to implementation of funding models.

## BARRIER 1: LEGAL AND REGULATORY RESTRICTIONS

Israeli social enterprises are organized in a variety of legal forms, each with its own consequences.

Social enterprises fall into a gray area of Israel's tax and corporate law. They do not exist solely to maximize profits, so laws governing for-profits clearly do not apply. But because they often are designed to pay dividends and show profits, neither do they fall under the purview of current NGO regulations.<sup>6</sup>

These legal and tax challenges have led to a number of ad hoc solutions. Some nonprofits have created profit-based subsidiaries, while others have partnered with for-profits that forgo the tax advantages and absorb the additional costs. In each case, these social ventures have been burdened with added legal and reporting costs, complex transaction fees, and the risk of tax penalties. In addition, government tenders for services may be limited to certified NGOs, thus precluding the participation of other private and/or for-profit enterprises.

Lab participants described a number of legal and policy mechanisms being considered or in place in other countries,<sup>7</sup> and tried to identify policies that could be replicated in Israel. Table 2 highlights the best practices recommended for adoption. Specifically, Lab members suggested the implementation of a new definition for Israel's "social benefit corporations," one that includes quantifiable impacts, a business model that allows for growth with the market, and a sustainable balance between creating incentives for investors and delivering social returns.

An additional legal challenge is found in the regulations governing foundations and their endowments. An important aspect of philanthropy is its ability to invest and grow its funds. In the United States, foundations have a mandatory 5 percent payout to nonprofits but are able to invest the remainder, allowing for philanthropic endowments that total over \$600 billion nationally.

With the exception of traditional grant giving, Israeli-based philanthropic capital cannot be invested in the social sector. Rather, the philanthropic capital is invested in traditional securities, and only the earnings are distributed to the social sector. Israeli foundations also cannot accrue tax-free capital gains. Because of limits to their size and flexibility, they are not able to use their balance sheets to leverage investments. Complexity in translating

### Examples of new social enterprises in Israel

- **Lilith:** a partnership between a profitable social enterprise in Tel Aviv providing fine dining and employment, and Elem, an NGO serving at-risk youths
- **Cinderella:** a for-profit social enterprise offering domestic cleaning services, employing disadvantaged populations in the Negev, and building opportunities for advancement of new jobs
- **Nahalagat:** a Tel Aviv NGO providing theater and dining, employing blind and deaf adults
- **Galil Software:** a for-profit software service company providing code outsourcing jobs for residents of Nazareth

tax-exempt eligibility between U.S. (501(c)(3) and Israel (Paragraph 46) creates a barrier to the U.S. diaspora's interest in investment; considering its financial capacity, this is a significant barrier to expanding social investing.

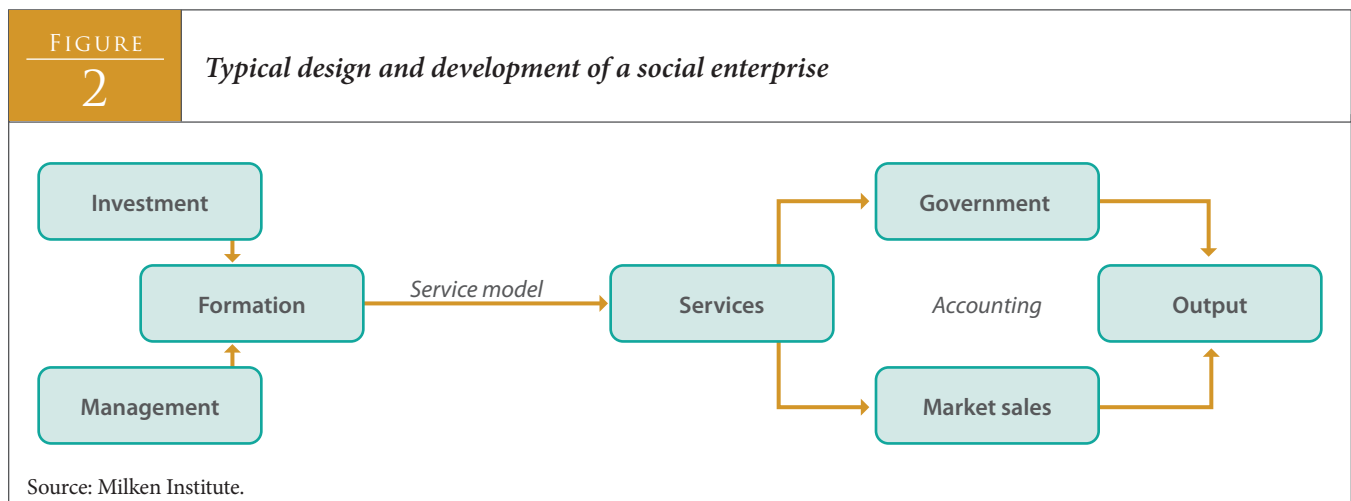
TABLE 2		<i>Legal best practices</i>
Legal form	Purpose and description	Where it applies
Public benefit corporation	<ul style="list-style-type: none"> <li>A significant proportion of its goals must be for the benefit of society or the environment.</li> <li>It must provide a broader definition of its obligations of trust vis-à-vis its employees, the community, and the environment when making decisions.</li> <li>It must have an increased reporting requirement, which mandates that it issue public reports written by a third party using objective tools to evaluate its performance in the social and environmental arenas.</li> </ul>	U.S.: New York, California, Vermont, Maryland, New Jersey, Virginia, and Hawaii.
Low-profit, limited liability company (L3C)	<ul style="list-style-type: none"> <li>No general requirement that maximization of profits be its sole or at least its main goal.</li> <li>It has both a primary objective—social or environmental—and a secondary objective—turning a profit.</li> <li>Liability protection of a corporation.</li> <li>Flexibility of a partnership; ownership is based on shares; not tax-exempt.</li> <li>Qualifies as a beneficiary of foundation-based program-related investments (PRI).</li> </ul>	U.S.: Illinois, Michigan, Utah, Wyoming, Vermont, North Carolina, Rhode Island, Louisiana, and Maine.
Community-interest company	<ul style="list-style-type: none"> <li>Commercial, profit-making entity with an interest in social good; it may be created as a subsidiary of a private enterprise; directors may be paid; assets remain with the CIC or charity.</li> <li>May be a private company limited either by guarantee or by shares or public, share-based companies; can make limited dividend distributions to shareholders; must submit public financial and social returns; costs may be treated as business expense.</li> </ul>	U.K.

Source: Yaron Keidar, Milken Institute.

Lab members proposed policy changes, including a proposed amendment to the law that would create public benefit corporation funds (Keren Cheletz in Hebrew). These new funds would create tax incentives to philanthropists to establish Israeli-based endowments. Similar to endowment funds in the United States, the proposed Israeli funds would give immediate tax credits to their donors, allow investing the principal funds to grow the endowment, and provide a sustainable source of investment and support for the social sector. Participants also suggested the proposed endowments funds be allowed to use principal to make program-related investments, such as loans and guarantees. Regulatory changes could also include a new category that would allow foreign-owned endowments to operate in Israel, bringing the diaspora's investments to bear.

BARRIER 2: REVENUE CHALLENGES

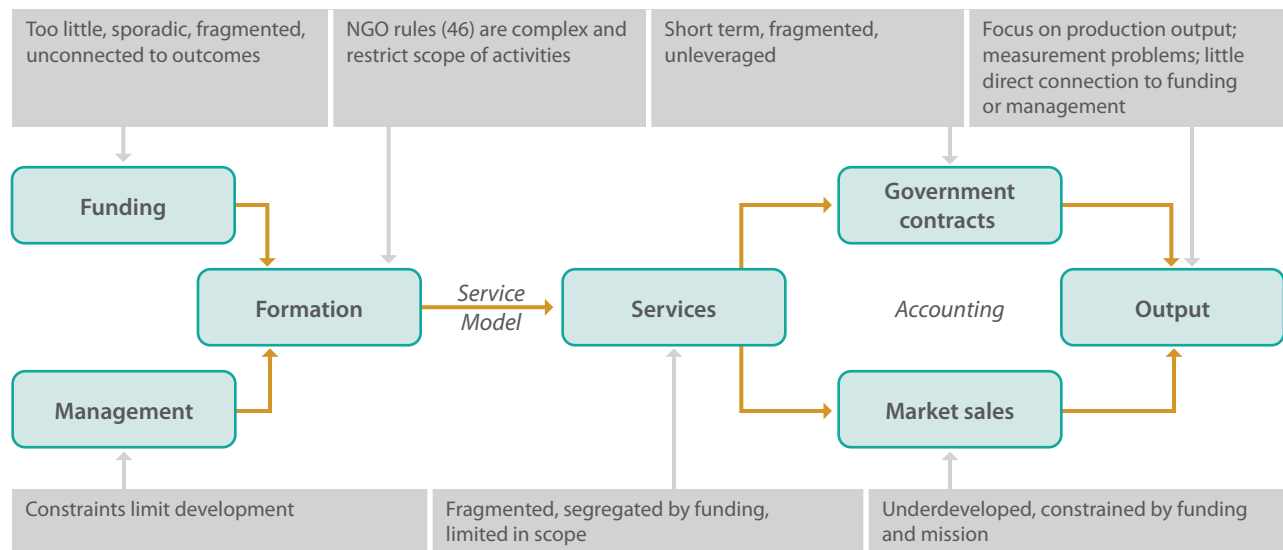
Social enterprises, however broadly defined, are mainly organized to respond to the missions of their funding sources, rather than to create efficient, sustainable investment and business models. As shown in figure 2, they are typically built on a “service” model, i.e., the funder, usually a government or foundation, is buying services for a targeted population. The delivery system is usually based on an “accounting” of the outputs—the market pays for a level of service measured by how much is spent and how many are served—and not on building organizational capacity to develop effective services and successful outcomes, which admittedly are difficult to measure. For example, social enterprises may measure the number of youths enrolled in an after-school mentoring program, the number of meals provided to poor, or the beds available to homeless families. These are not outcomes in terms of resolutions, and may or may not be related to qualitative performance outcomes.



The challenge is to construct not only service-delivery models but also revenue models based on quantitative and qualitative outcomes (e.g., more graduates and greater educational achievement, less recidivism, less environmental mitigation, lower disease incidence). But Lab participants also warned that this could make social enterprises vulnerable to the problem of “perverse incentives,” which occur when an organization is rewarded for acting against its own mission, such as shifting its focus to easier-to-serve populations. (It was noted as well that not all social enterprises use revenue models based on outcomes alone.)

Social enterprises that use revenues from a profitable subsidiary also carry higher tax and regulatory burdens.<sup>8</sup> And unlike scalable, profit-driven enterprises, they go through flat cash flows during the growth phase. As a result, funding and financing options for social enterprise to deliver needed social services are limited, constrained, and unsustainable.

Organizations are committed but lack capacity. Underfunding often leaves them inadequately staffed and without beneficial “business” controls. Funding is the first point of reference for enterprise formation. Its management group generally produces a service model, and because the funding is marginal, there is limited capacity to innovate, and little feedback or incentive to improve performance (see figure 3).

FIGURE  
3*Obstacles to development and growth*

Source: Milken Institute.

A shift to social investment will first require that a social enterprise has net operating income, that is, its operating revenues must exceed expenses. As in a typical for-profit business, net operating income would allow the social enterprise to offer returns to its investors, either in the form of loan repayments or dividends. The return may be small and over the long term, but it should exist. And this requires revenue. The Lab involved a discussion of several revenue models:

- **Market sales model:** Services and/or products (such as restaurant and skills training, cleaning, etc.) marketed to a broad customer base to generate gross revenues. Because these sales are market-based, the social enterprise must be able to compete for customers, adapt strategy to respond to market preferences, and refine its products and services.
- **Government contracts/fixed-cost model:** Government contracts for services are usually short-term, lasting one to three years, and highly regulated. They are usually awarded through a complex and competitive tender process. Awards are difficult to predict and hard to use as security for financing.
- **Government services/performance bonus model:** Contracted services, with bonuses based on performance, have been in use in such areas as infrastructure construction. Suppose a contractor finishes ahead of schedule; he or she receives a performance bonus in addition to the fee. Israel's public health funds (Kupot) are examining ways to share savings among hospitals and primary-care providers that demonstrate better outcomes, such as a reduction in hospital admissions, that reduce overall health-care costs.

Similarly, social enterprises (or their investors) that provide government services may be rewarded for better outcomes, such as lower school dropout rates, higher school achievement, better nutrition, and higher employment

rates among served populations. Each positive outcome lowers the overall direct and indirect costs to the government; the reduced costs could be used as a measure for bonuses because the “cost avoidance” they produce results in slower rates of cost increases and, ultimately, fewer taxes increases. By developing strategies that focus on cost avoidance, surplus dollars could be generated for reinvestment in social infrastructure (buildings and facilities, maintenance) and social service delivery.

In short, these mechanisms of revenue production could use results-based payments to spur innovation and accelerate the development of the social enterprise markets.

Each of these revenue models has different features, including how it handles risks, how flexible it is to design and manage, how complex it is to implement, how difficult it is to measure, how accurate it is to predict performance, how scalable it is, and what to expect in terms of returns (social and financial). Clearly, fixed-cost government contracts are easier and contain low risk, but they also are limited to the size of the government contract, usually provide a fixed marginal cost for the services, and offer the lowest returns to investors. Market sales and performance-based contracts may be more complex and offer some risk, but they also offer the biggest potential for growth, reduce the marginal cost of their services, and increase returns to the investors.

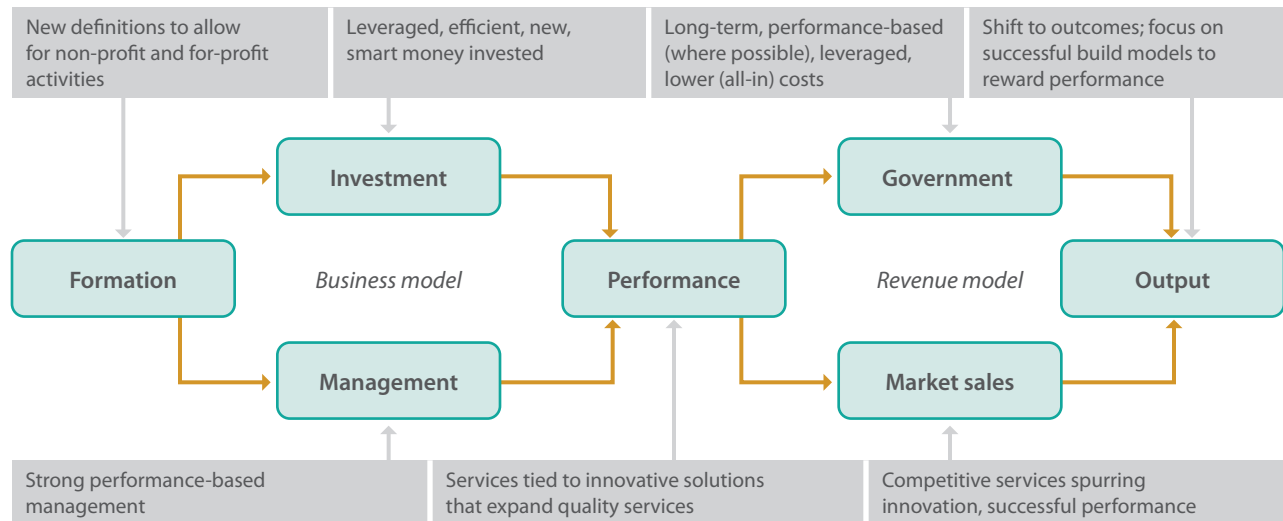
<b>TABLE</b>		<i>Revenue model comparison</i>		
<b>3</b>		<b>Market sales</b>	<b>Fixed-cost government contracts</b>	<b>Performance-based government contracts</b>
Market risk	High	Low	Low	Low
Performance risk	High	Low	Low	High
Flexibility	Low	Low	Low	Moderate
Complexity	Moderate	Low	Low	High
Measurement	Easy	Easy	Easy	Difficult
Predictability	Low	High	High	Moderate
Scalability	High	Low	Low	Moderate
Potential returns	Moderate	Low	Low	High
Applicability	Indirect services to special populations	Schools, hospitals, community facilities	Schools, hospitals, community facilities	Improve health care, reduce recidivism, employ structurally disadvantaged populations

Source: Milken Institute.



FIGURE

4

*New approach to social enterprise development and growth*

Source: Milken Institute.

## BARRIER 3: ACCESS TO CAPITAL

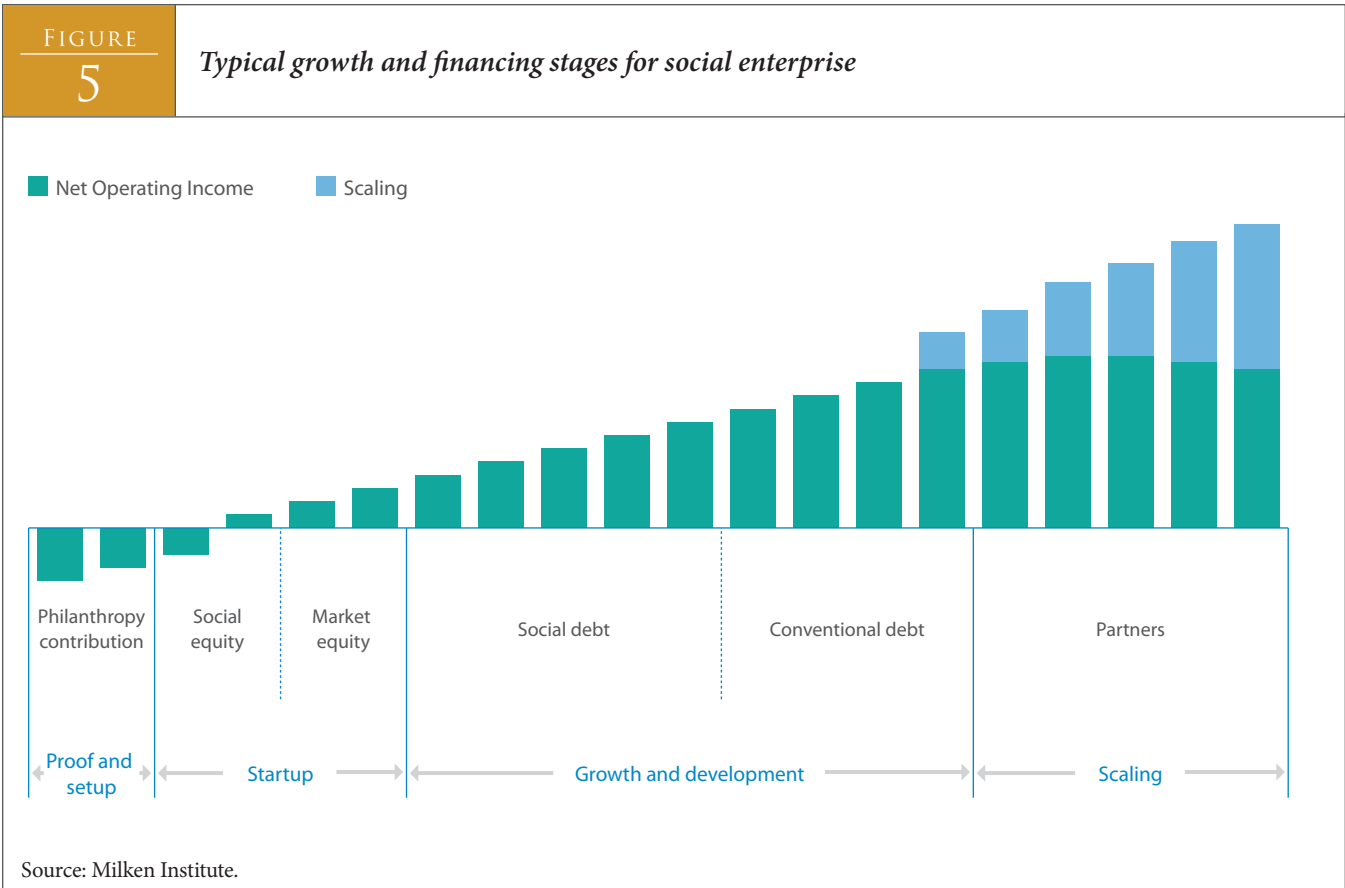
Government and philanthropy are the traditional funders of social enterprises. But increasingly high levels of annual defense spending have left the government with fewer budgetary resources for social services without the imposition of new taxes or more public borrowing. There is a real need to do more with less. And the philanthropy sector is showing a heightened interest in “investing” funds with social enterprises rather than “granting” money to them.

As noted, traditional capital sources, such as private equity, bank lending, and capital market institutional financing, are typically not available to social enterprise because it lacks a traditional revenue model. Conceptual cash-flow projections for social enterprise usually lack the “growth acceleration” phase found in for-profit startups and other enterprises, which allows them to return capital to equity holders. The absence of a “terminal” event, such as an IPO or acquisition based on this growth acceleration, limits the return on investment to market-rate investors. This is an important financial challenge for conventional investors.

Figure 5 describes a typical growth pattern found among social enterprises. At each stage of growth, the financing options change. This figure highlights the need to have and use the right financing tool at the right time. Each tool must be part of a new social investing environment that feeds the delivery of strong and sustainable social enterprises.

FIGURE  
5

*Typical growth and financing stages for social enterprise*



Bridges Ventures is a venture firm that invests only in the poorest 25 percent of Britain. We promised investors a 10 percent to 12 percent net IRR, half a venture return. Today Bridges has more than £300 million under management and is delivering 17 percent to 20 percent net IRR by investing in for-profit, mission-driven [enterprises] in the poorest parts of Britain.

—Sir Ronald Cohen, Portland Trust

## Financial and Policy Innovations to Support Social Investing

Lab participants agreed that a number of opportunities exist for Israel to open access to conventional and new capital markets, and introduce novel organizational mechanisms that allow partnerships to form between governments, NGOs, and private enterprise. These approaches could build on new market-based and performance-based models that hold beneficiaries accountable, reward performance, and share risk proportionately.

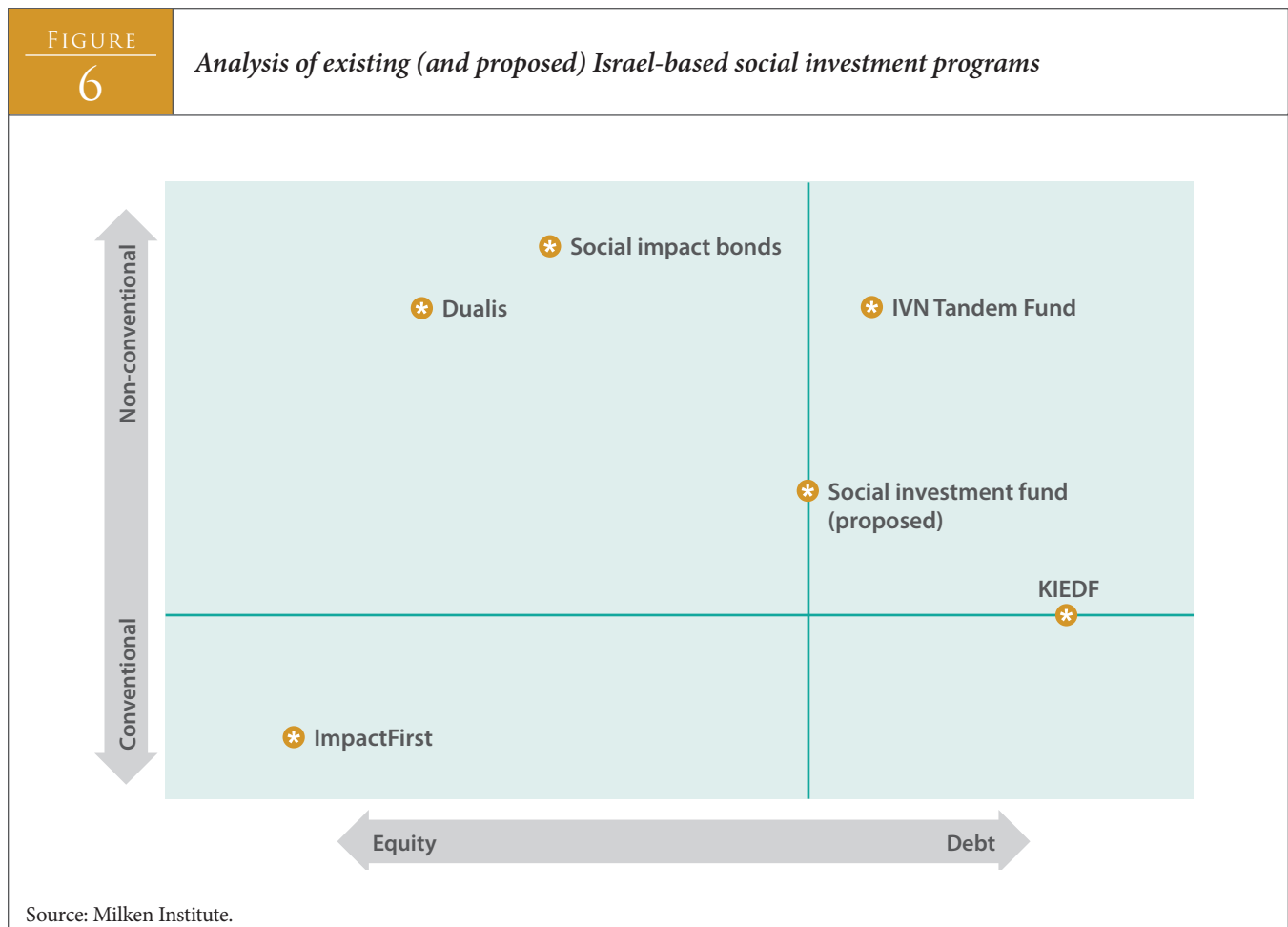
### SOLUTION 1: SCALE UP CURRENT FINANCING PROGRAMS IN ISRAEL

Israel is already home to several successful though limited programs in social investing that act as conduits for philanthropic and private capital to social enterprises. Representatives from several of these organizations, established as either NGOs or private social equity funds, attended the Lab and provided insights into their design and programs. Each has developed methods of partially overcoming the various barriers identified in the Lab. However, they are all limited in their ability to raise money, invest in social enterprise, and offer a return to their investors.

- **Dualis** is a nonprofit fund that invests in for-profit social enterprises that have the potential to grow profits and create a social impact. As an “involved” investor, Dualis offers support and guidance, and expects to see profits that in turn will be used to support additional social business initiatives. A popular Dualis model has been the public-private-social partnership (PPSP), combining business investment and direct support for NGO-based social services with for-profit social enterprises. Since its founding in 2009, Dualis has invested in nine social enterprises.
- **ImpactFirst Investments** is a social venture fund founded in 2011 that focuses on for-profit ventures committed to providing social goods and services. The fund is raising approximately \$25 million for 12 to 15 investments, with a portfolio return on investment of approximately 6 percent to 8 percent. The fund is structured similar to a venture capital model with a limited- and general-partner structure. It targets for-profit social enterprise ventures that offer long-term growth potential and substantial returns to investors. The structure of the fund does not provide any tax benefits to investors.
- The **Israel Venture Network** (IVN) identifies social needs, formulates innovative responses through social enterprises, and mentors the social enterprises through startup, growth, and sustainability phases. IVN’s Social Venture Program combines mentoring with targeted investment (either through equity or debt). It has formed a new loan fund, the IVN Tandem Fund, which will be capitalized with \$5 million—half from U.S. investors—to focus on early-stage social enterprise development (prior to positive cash flows). It is attracting these funds on the basis of the tax deductions. Dividends will not be distributed. Repayments will be reinvested in the fund, to be deployed across 20 or more social enterprises. The tax benefits for investors in these funds are based on U.S., not Israeli, tax laws. As a result, Israeli investors are not given an incentive to invest.
- The **Koret Investment and Economic Development Fund** (KIEDF) leverages philanthropy to facilitate bank financing to small and medium businesses, micro enterprises, non-profits and social enterprises unable to secure

traditional credit. KIEDF uses philanthropic contributions to guarantee up to 95 percent of bank loans to small and medium enterprises in Israel's Galilee and Negev regions. KIEDF makes a linked deposit in a bank, which makes a loan pursuant to KIEDF's due diligence and approval. The bank has rights to a KIEDF guarantee. At the same time, KIEDF has the ability to cure a default, stepping in on behalf of the borrower. KIEDF offers social enterprise funds and related initiatives the opportunity to leverage fund equity to provide working capital to invested companies. Since 1994, KIEDF has facilitated over \$300 million to more than 11,500 enterprises while creating and supporting 50,000 jobs. KIEDF recently developed a \$1 million pilot program funded by the San Francisco Community Foundation to expand its portfolio beyond business lending to social enterprise.

Figure 6 depicts how these social investing programs, including two proposed programs, rank on a conventional to nonconventional basis, in terms of market and methods, and on a debt-to-equity basis, in terms of tools and practices.



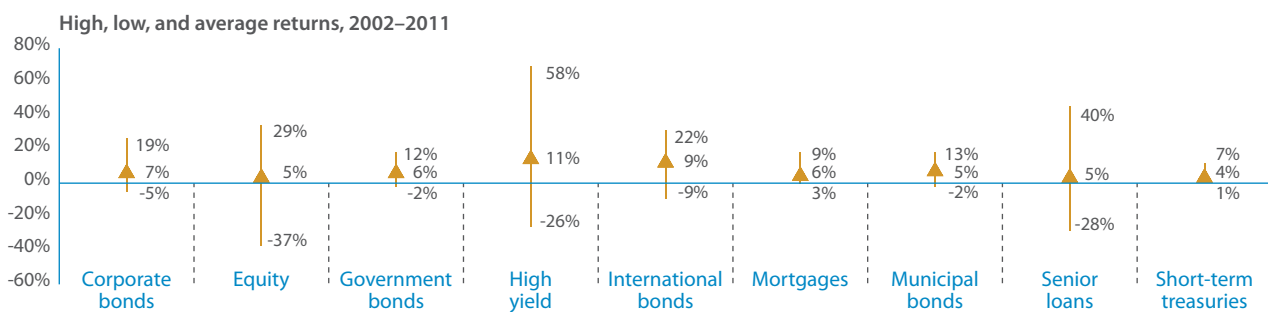
## SOLUTION 2: REPLICATE BEST PRACTICES FROM ABROAD

Participants described several examples of social investing programs worldwide, including private equity funds (DBL Investors, <http://www.dblinvestors.com>) with a social bottom line; an angel network (Grand Challenges, <http://www.grandchallenges.org>) that seeds social entrepreneurs; an equity fund (Bridges Ventures, <http://www.bridgesventures.com>) that invests in distressed communities; a performance-based bond (social impact bond) that leverages capital market investors to fund targeted social issues (<http://www.socialfinance.org.uk>); direct lending links (community investors) to community-based organizations; and crowd-funding strategies (Calvert Community Investment Notes, <http://www.calvert.com/sri-community.html>) to mobilize new debt for distressed communities and populations.

Figure 7 shows the window of returns among a variety of asset classes representing opportunities for equity and debt investors in the capital markets. It is clear that satisfactory returns are possible across a spectrum of the social-investing asset class. For example, Lab participants reported that socially responsible investments have been shown to achieve competitive, market-rate returns. The U.K.'s Big Society Capital and Charity Bank programs target distressed populations and places using a range of equity and lending models described in the Lab. They are expected to produce returns of around 12 percent to 17 percent, sufficient to attract philanthropic endowments, pension funds, and insurance funds with fiduciary responsibilities.<sup>9</sup>

FIGURE  
7

Comparison of historical financial returns from various asset classes



Source: Lipper Data, 2012, Milken Institute.

U.K. social impact bonds are designed to yield from 2.5 percent to 13.5 percent to investors, based on the performance of the service providers.<sup>10</sup> Other social equity funds, such as Dualis, have realized 7 percent returns on equity. Revolving loan funds, to be discussed later in this section, have generated returns of 3 percent to 5 percent on principal loaned to social enterprises, even accounting for program operations and loan losses.

Hybrid financing models that combine equity and loans can be designed to create a minimum payout both through preferred interest payments on a portion of the investment and an equity kicker on the back side of the project when revenues are flowing and non-preferred equity is repaid. The Soros Economic Development Fund, which combines



debt and equity in many social enterprise transactions in developing countries, reports a combined long-term return on investment in projects of between 6 percent and 8 percent, and that return should be acceptable for most long-term institutional investors.<sup>11</sup> At the same time, the Soros fund measures success in part by operational self-sufficiency.

Based on these examples, Lab participants highlighted several general models that illustrate how social enterprises could be financed. Each model includes several components: sources of funds, mitigation of “intermediary” risk, management, services, and beneficiaries. These examples include direct investment through equity and loans, bank loans secured by guarantees, performance-based bonds, and credit-enhanced revenue bonds.

The first model, a social equity model, provides a venture capital platform composed of senior equity investments in a social venture capital fund. These senior equity investments are treated like limited-partner capital with a priority return on the principal investment and a preferred return on interest payments, if any. The limited-partner equity can also be broken into lower, or subordinated, returns, depending on expectations and timeframes for recovery of capital.

The social venture capital model is managed by a general partner that may be paid on a contingent or performance basis.<sup>12</sup> Similar to market-rate private equity and venture capital funds, the social venture capital fund brings “smart” capital in the form of technical assistance, market and management guidance, and even board leadership, along with various stages of capital needed to build the enterprise.

A second model operates on the debt side of the financing continuum for social enterprise, the revolving loan fund (RLF) provides a sustainable financing conduit capitalized with some level of equity, again a mix of equity with preferred returns and equity with a longer-term, patient expectation of returns. This equity mix leverages a capital market loan, in the form of a revenue bond, secured by loan receivables to the revolving loan fund by its portfolio of social enterprise loans. This bond is senior to the equity and supported by a reserve fund, partially funded by project capital, equity, and philanthropy or government. A revolving loan fund provides added value in terms of strict underwriting, due diligence, and loan management that leads to a strong, blended portfolio of performing loans and the long-term viability of the fund. Over time, RLFs have sold or refinanced their portfolios in the capital market after demonstrating a strong financial track record.

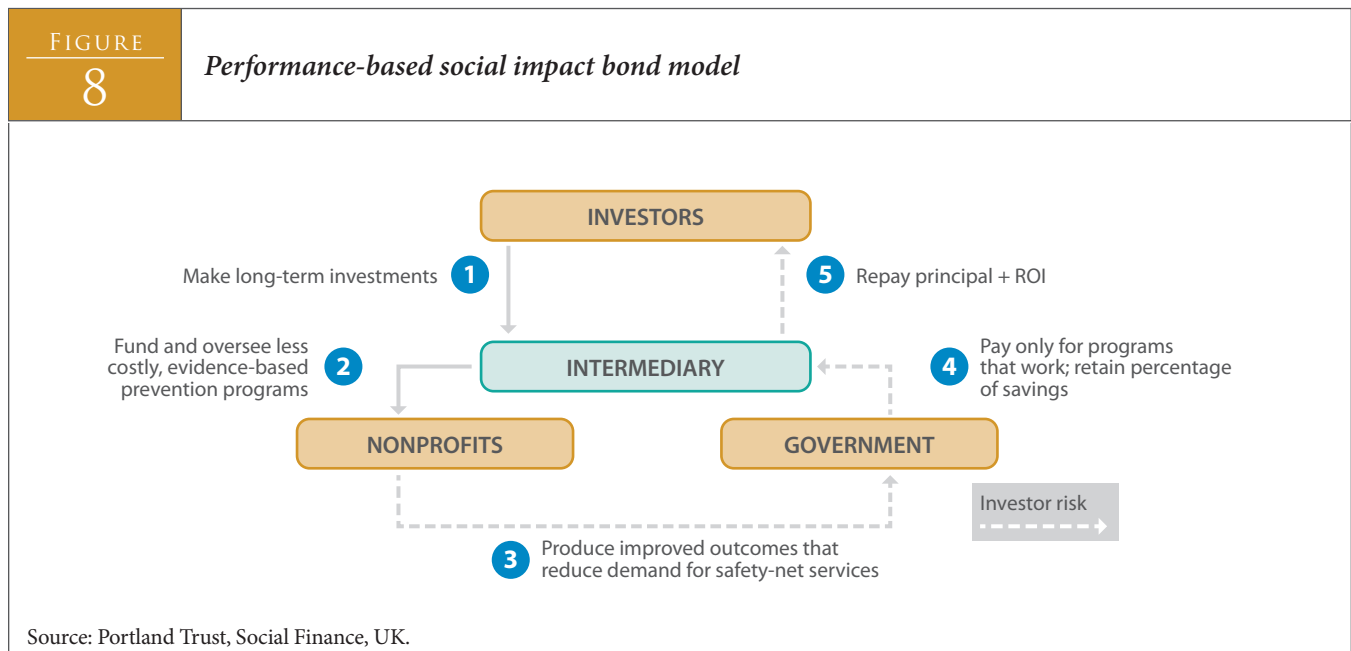
The performance-based bond is a third model. This bond, also called a social impact bond, leverages equity to create a pool of capital from the capital markets for investment in social enterprises through a financing intermediary. The intermediary focuses the bond proceeds on a particular social issue and seeks solutions that demonstrate measurable results and cost savings to the public sector (which is responsible for paying for the targeted social solution). The capital is provided by the intermediary to the social enterprise. As a result of improved quantitative and qualitative outcomes, the government enjoys a reduction in costs and possibly a reduction in taxes. Finally, a preset portion of the savings is returned to the financing intermediary, which returns the capital to the bond investors as repayment and return on investment. If there is no significant improvement, the government is not obligated to repay the intermediary (and thus investors), thereby shifting the financial risk to the capital market. In this way, the financial return to the intermediary is dependent on the degree of success of the social enterprise.

The social impact bond delivers a number of direct benefits:

- The investor can earn an acceptable rate of capital return.
- The social enterprise is financed using new, sustainable capital, which enables it to scale up its successful social interventions.
- The government enjoys a cost saving with no upfront investment.
- Financial risk is transferred to the private investor.
- The “underlying” social ill is improved.

FIGURE  
8

*Performance-based social impact bond model*



There are other models as well. The bank guarantee model, for example, offers a way to leverage bank loans with deposits in the bank, payable in the event of a default. This model is used to great effect by the Koret Investment and Economic Development Fund, which provides philanthropy for its deposits. To enhance its leverage, KIEDF has structured a second-tier guarantee through the Overseas Private Investment Corporation, a U.S. government-sponsored fund, to provide \$10 million in credit support for projects in Israel’s northern and southern regions. As shown in table 4, each Israeli program has a target, main instrument, and activity, and expected financial and social return on investment.

As part of the Lab discussion, and as illustrated in the 2012 paper “A Social Capital Market for Israel: Report of the Working Group for Social Investment,” the U.S. social investing eco-system was described.<sup>13</sup> In particular, it was used to point out not only the complexity of the interlocking and mutually depending pieces of the U.S. system, but also the missing pieces of the system infrastructure in the Israeli market.

TABLE  
4*Summary of Israeli social investing programs by applicable program model*

	Social equity model	Social debt model	Performance-based social impact bond model	Bank guarantee model	Credit enhancement model
<b>Type of instrument</b>	Equity	Loan	Performance-based loan	Guarantee	Revenue bond (supported by a standby balance sheet commitment)
<b>Examples of intermediaries</b>	Dualis ImpactFirst	Israel Venture Network (IVN)	Social Finance: Israel (proposed)	Koret Investment and Economic Development Fund	Regional financing facility (proposed)
<b>Examples of projects</b>	Lilith Restaurant Galil Software	Cinderella	Employment for Haredim (proposed) Prisoner rehab – U.K.	Nahalagat (theater and café)	Schools, incubators, industrial parks
<b>Returns on capital</b>	~7%+	~4-7%	~0-13%	P+1.5%	~3-5%
<b>Examples of social returns</b>	At-risk youth employment and services	Job placement, transportation, fair labor practices, and vocational training	Job placement and counseling services; innovative approaches	Employment for hard-to-serve populations	High leverage of new capital; community-based facilities; economic development

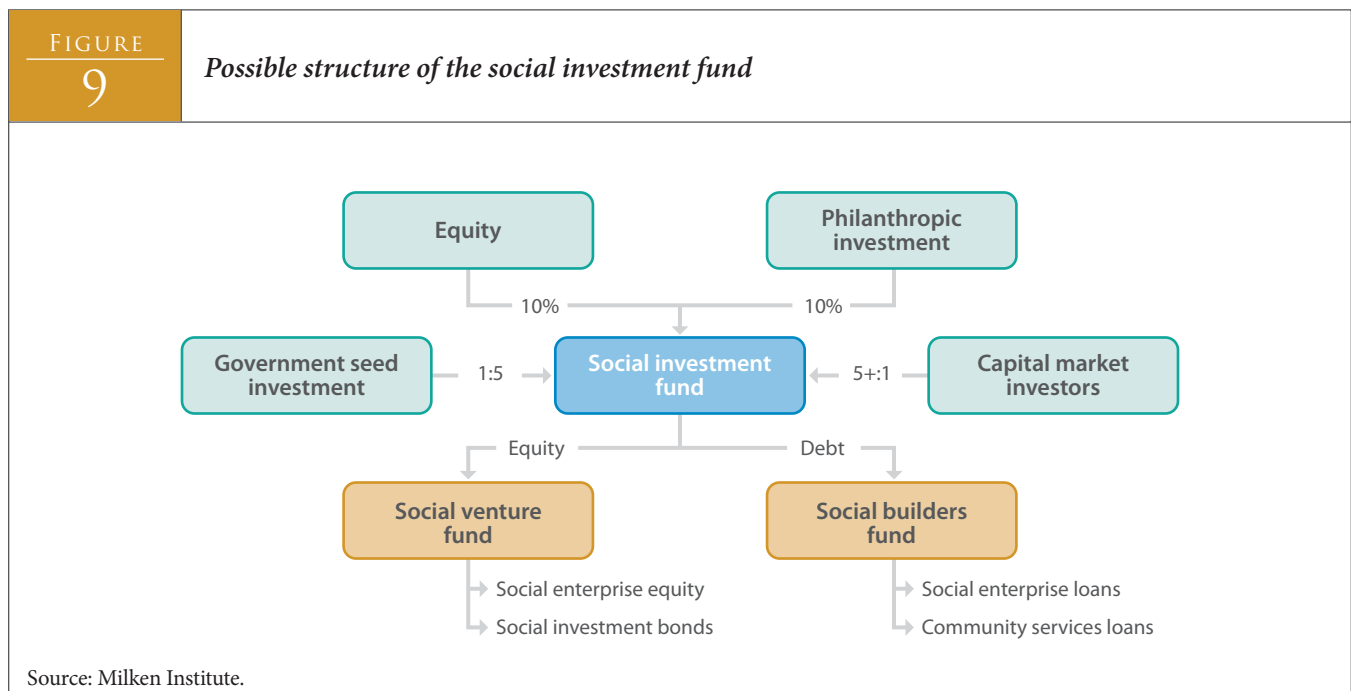
Source: Milken Institute.

### SOLUTION 3: ESTABLISH A SOCIAL INVESTMENT FUND

Yozma (in Hebrew, “entrepreneurial initiative”) began as an initiative of the Israeli government in 1993 and led to the creation of Israel’s venture capital industry. With an initial government investment of US\$100 million, Yozma created 10 “drop-down funds” in partnerships with foreign VC managers, leveraging over \$170 million from U.S. and European private equity for Israeli companies, and fueling the expansion of technology development and exports over the next 15 years. Each Yozma fund had a call option on government shares at cost (plus interest) for a period of five years.<sup>14</sup> Thus, Yozma did not simply share the risk with investors; it also provided an upside incentive (the private investors could leverage their profits through acquisition of the government shares, and they did). Eventually, all government interest in the original Yozma funds was bought out.

Many Lab participants cited the Yozma investment fund as a model for financing and leveraging the social sector. The group discussed the creation of a social investment fund to direct capital to intermediaries in the market that would make the actual investments in social enterprise.

The social investment fund would be a flexible pool of capital for funding multiple specialized funds targeted to particular segments, or types of entities, in the market. For example, as shown in figure 9, it could capitalize a social venture fund that would target equity or equity-like investments in social enterprises tied to outcome performance. In turn, a social builders fund would use loans for a variety of social enterprises when the repayments are under contract and scheduled.



The variety of investment types, equity and loans offers a mix of project types, repayment expectations, and performance risk.

The capital structure includes equity—either private investors with an appetite for social investments or the allocation of unclaimed assets from Israeli banks, pension funds, and insurance funds. Among philanthropies, participation in a social investment fund could include setup and startup capital. Philanthropy investments might be in the form of recoverable grants or “patient equity,” paid back in the longer term. Depending on the terms of the philanthropic investment, repayment could be in the form of a charitable contribution and stay in the larger social investment fund.

A government seed investment might be structured as an initial patient investment, perhaps with a deferred and maximum repayment amount. Part of the government seed investment could also be structured as first-loss reserve funding to act as a cushion for market-rate capital market investors. Finally, the market-rate capital market investors would be given a prior repayment, with a minimum and maximum return on investment.

## SOLUTION 4: CREATE POLICY TOOLS TO PROVIDE INCENTIVES FOR SOCIAL INVESTMENT IN ISRAEL

An important aspect of the new social investment environment, or ecosystem, is the need for tools that enhance the attractiveness of investments by shifting risk, lowering cost, increasing returns, or any combination of the three. The examples of tools and programs offered by some of the leading social financing organizations provided insights into a fully function ecosystems where the components are mutually supportive and have proved to be sustainable, as illustrated in figure 10.

Lab participants emphasized the need to consider these tools and to adopt their use. At the same time, they generally agreed that the new systems will require investors, money managers, program managers and operators as well as enterprise management with experience and expertise in the social investing market.

Lab participants agreed that the financial tools needed to attract capital to the social investment market include:

- **Tax deductions:** Current tax laws limit the amount that can be contributed to an eligible nonprofit and deducted from the payer's income in a given year. The amount of this limitation should be raised substantially.<sup>15</sup>
- **Tax credits:** Tax credits reduce the tax obligation of individuals and corporations. They are already used in the technology sector as an incentive for investments in R&D. Tax credits can be expanded to target equity contributions for social enterprises or for social funds that support social enterprises.<sup>16</sup> Tax credits should be able to be carried forward on future tax obligations and transferable to allow their sale and trade.
- **Tax-exempt financing:** Eliminating the tax on the interest payments from bonds or bank loans has the effect of lowering the interest rate charged to the borrower. This source of lower cost debt, perhaps 2 percent to 3 percent below commercial rates over a long term, could help with the cash flows of social enterprises by improving the efficiency of their revenue models and the feasibility of their ability to finance debt.<sup>17</sup> This would be crucial for capital-intensive projects, such as schools, hospitals, community centers, etc.
- **Performance financing:** To issue performance-based bonds, the government should strengthen the budgeting process to allow payments based on performance. This new budgeting process would be based on some portion of the projected "savings" (or avoided costs) from the social enterprise that received the investment from the performance bonds.

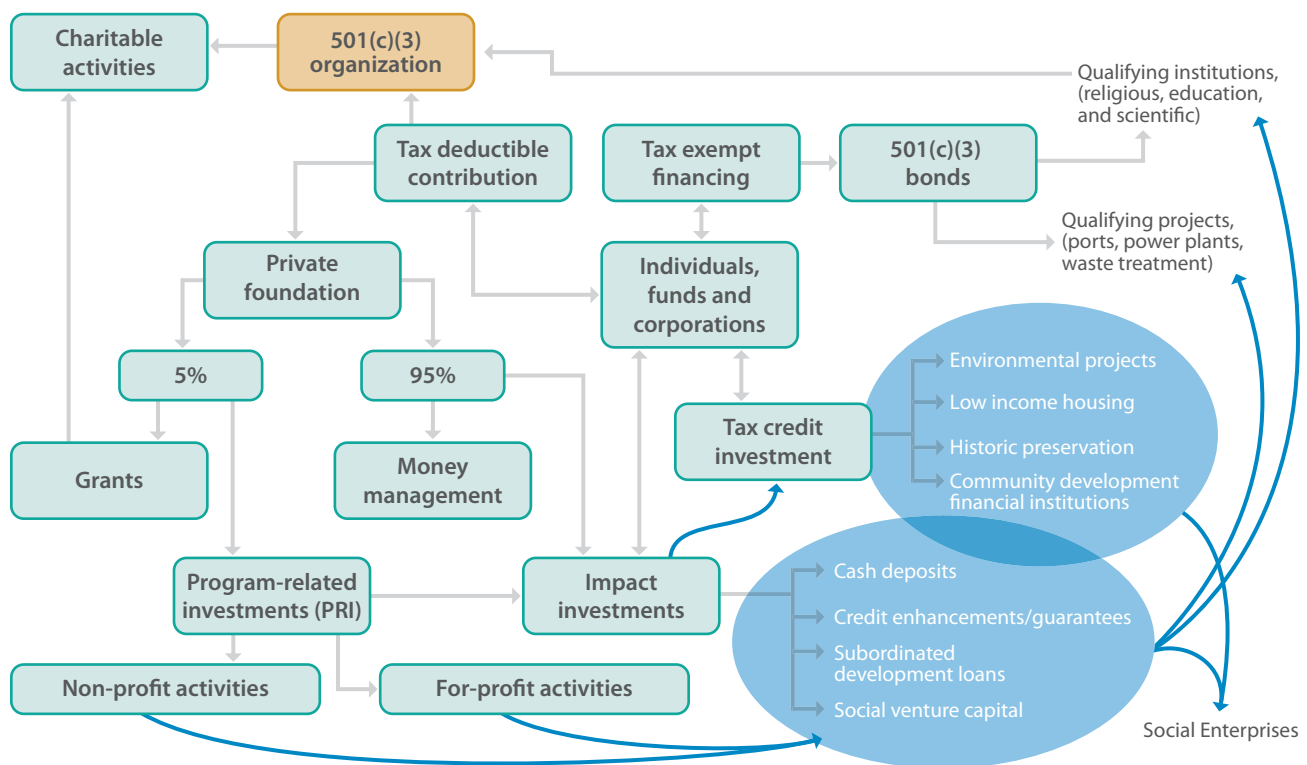
The following policy tools can be applied singly or in combinations to increase the leverage of private capital.

- **Social enterprise:** A new form of legal entity should be defined; while we can describe social enterprise as both a nonprofit or for-profit enterprise, existing law is not so generous. A for-profit social corporation does not fit under the regulations covering NGOs or regular companies. Therefore, Israeli corporation laws must be amended to allow for a new class of "benefit corporations" that provide public benefits to the organization but also maintain the public purposes of the organization.
- **Philanthropic funds:** Under current law, charitable contributions must be made to a certified NGO or public-benefit corporation, which must spend its charitable revenues according to its bylaws and charter, and in accordance with the tax requirements. It may not retain and build funds while granting the charitable deduction to its benefactor. This has the effect of limiting the growth of philanthropic funds. The Knesset is considering an amendment to the law to allow for the creation of philanthropic funds.<sup>18</sup> This would also lead to the creation of asset management capabilities, allowing Israel to attract the large market of donor-advised funds to the country.

- Social enterprise bonds:** The Israeli Securities and Exchange Commission should clarify how to classify and register traded revenue bonds to support social enterprise activities, similar to U.S. 501(c)(3) bonds, which are used to support capital improvements for schools, hospitals, community centers, and other social enterprise assets. Creating a classification for social enterprise bonds as registered private placements would let them raise longer-term, lower-cost funds in the capital markets.
- Markets:** Many Jewish community federations in the United States are restructuring their Israeli philanthropy in response to member interest. It is important to capitalize on this change.
- Measurement:** Younger potential donors who are amassing significant capital don't have the traditional connections to Israel and are metrics-driven. The modern donor is less of a grant-maker and more of an investor in a social enterprise, willing to take a below-market rate of return in exchange for results that clearly fill a market gap for the targeted community. A scorecard that many social investors are trending toward can be found at <http://iris.thegiin.org/>. It will be important to formulate a similar mechanism to measure and compare the outcomes from social investments in the Israeli market.

FIGURE  
10

*Social investing ecosystem*



Source: Milken Institute.



We need to create history.  
We need to create success stories. We need to ensure expertise, to create expertise on the parts of investors, how do they measure things, not only in the for-profit domain.

—Eugene Kandel National Economic Council

## Conclusion

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The challenge is to move forward quickly to take advantage of the combination of influences that will tap the new momentum in the market and draw solutions forward. Based on the discussion among Lab participants, we conclude the following:

1. **Build a scalable system.** Rather than focus on programs or tools that will be necessary, take the steps to design and implement a sustainable investment environment with inter-related activities, actors, and outcomes. Design linkages between the components of this system, and develop tools to encourage the components to work together.
2. **Encourage social entrepreneurship.** New approaches and solutions may be more efficient and effective in producing outcomes.
3. **Engage market-based solutions.** Design incentives to encourage social entrepreneurs to exploit market-based opportunities, aligning revenues, profits, and outcomes.
4. **Leverage the global capital markets.** Social needs require new money and more money, not just the reallocation of existing public and private funding. Design approaches that attract new sources of equity and debt through the capital markets in Israel and abroad, leveraging the unique connection and depth of the Jewish diaspora.
5. **Invest in capacity.** With so much of the work already being done in Israel through committed NGOs and innovative social enterprises, solutions must add capacity, not replace it.
6. **Attract “smart” money.** Use philanthropic and government resources to leverage “smart” money into the social investing economy, using good investment practices, strong business models, and compensation for talent and performance.



## APPENDIX A

*Design of the Investment Environment*

Lab participants addressed a series of questions about the design and scope of an improved system to support social enterprise. They suggested the following design features—not for use in a specific program or policy, but rather as a guideline for a range of policy and program elements in the social investment “system,” affecting the activities of the investors, financial vehicles, intermediaries, and social enterprises.

**Sources of Funds**

- What are the sources of funds?

Sources of funds include long-term, private, market-rate investors, philanthropic investors and grantors, and government grants and loans. For equity in the fund, the social investment network should have access to “public domain” sources of equity, including unbudgeted and public or quasi-governmental surplus funds, unclaimed insurance and pension funds, and dormant and unclaimed bank funds.

**Eligibility**

- Who should be eligible to participate (direct beneficiaries)?

The social investing system should support nonprofit as well as for-profit social enterprises that maintain a double bottom line—a focus on financial and social returns. The key element for the funds should be that they can receive philanthropic and government investments. For the social enterprise, the key is having a business and revenue model.

- What activities should be permitted?

Eligible activities should be proposed by the social entrepreneurs as part of their business models. These may include a range of capital and operating expenses that lead to successful outcomes and build a sustainable, scalable solution.

- What types of financial instruments are permitted?

Financial innovations should be encouraged. Building on successful and sustainable models, eligible financial instruments may include credit enhancements, direct guarantees, bank guarantees, first-loss pools, direct loans, direct equity, recoverable grants, or any combination of the above.

**Organization**

- Who owns the fund? How is it governed? How can it partner with other entities in the market?

The development of funds may take multiple forms. However, with the scope of the investors and goal of sustaining the funding over the long-term, it may be organized as a nonprofit partnership with all investors and even guarantors serving as “limited partners.” Under this arrangement, it would qualify as a corporation for the public benefit (Cheletz in Hebrew).<sup>19</sup> As a result, it would have a board of directors and meeting and reporting requirements, and allow for tax-deductible contributions/investments.

- How are investments managed? Can the funds contract for services? What type of staffing would be required?

One of the key requirements is that the funds be professionally managed. These services can be built internally within the funds or financing facilities, or contracted to others. However, the management

must be “value added.” That is, it must provide technical, management, and marketing services along with the investment. The funds must be proactive and aggressive to find good investments and manage those investments over its life.

### Terms and Conditions

- What are the costs of capital, amounts, and levels of participation?

The costs of capital should move in the direction of compensating for the risk of the investment, recognizing that there will be a mix of returns among investors and that risk can be managed in a variety of ways. The costs of capital, therefore, should take into account the realistic alternatives available to investors, given their legal and fiduciary requirements, and their program expectations. Similarly, amounts of investment and levels of participation should be used to balance program risk and project feasibility.

- What types of credit and collateral requirements are expected? How are investments secured?

Programs should be able to accommodate new social enterprises without a track record or financial assets or guarantees (e.g., personal). Investments should be flexible enough to evaluate the social entrepreneur’s experience and ability, the management team, the market, and the expectations of success. At the same time, investments should allow for credit underwriting, an appraisal of collateral, and documentation to secure the investment, where appropriate. The system must also be responsive and transparent to the needs of investors, who need to see the public commitment of funds (through appropriations, contracts, and program pools, etc.), and who require documentation of the funding into a social enterprise’s revenue model, including contractual methods to secure and “intercept” receivables, when needed.

### Returns

- What types of returns are social and financial expected and sustainable?

Returns on investment, including financial and social returns, are a function of sustainability. The funds should try to achieve a balanced return among market-rate, public, and social investors that maintains their interests in the system. However, with the types of asset classes being developed in the social investing system, investors should expect long terms and slow, gradual capital recovery.

- How are returns measured? By whom?

With a significant change from accounting to revenue models and from output to outcomes, the identification of acceptable returns and the measurement of those returns are a key part of the social investing system. The collection and analysis of data across departments and branches should account for the “real” cost and benefit of outcomes. These social returns, and the calculation of costs savings, must be part of the system.

- How are returns invested? When are returns paid out to investors? Under what conditions?

Returns will be paid to investors. The timing of payments, including interest, dividends, and return of principal investment, are all a function of the investment method. Investors should be permitted to “roll” their dividends back into new projects, giving them a preferred or priority return on subsequent rounds. The expectations of returns must be balanced with the nature of the investments and the sharing of returns among all investors.

Lab participants suggested that new funds or programs be subject to sunsets that will cause them to be liquidated at a certain term unless there is consensus to continue operations.

<b>TABLE</b>		<i>Key features of social investing network by stage</i>			
<b>5</b>		<b>Investors</b>	<b>Funds or financing facilities</b>	<b>Intermediaries</b>	<b>Social enterprises</b>
<b>Eligibility</b>	<ul style="list-style-type: none"> <li>• Government</li> <li>• Philanthropy</li> <li>• Institutional funds</li> <li>• Retail investors</li> </ul>	<ul style="list-style-type: none"> <li>• Corporation for public benefit (Cheletz)</li> <li>• Public authority</li> </ul>	<ul style="list-style-type: none"> <li>• Corporation for public benefit (Cheletz)</li> <li>• NGO</li> </ul>	<ul style="list-style-type: none"> <li>• NGO</li> <li>• For-profit social enterprise</li> </ul>	
<b>Organization</b>	<ul style="list-style-type: none"> <li>• Loans</li> <li>• Guarantees</li> <li>• Investment agreements</li> </ul>	<ul style="list-style-type: none"> <li>• Limited partnership</li> <li>• Board oversight</li> <li>• Investment committee</li> </ul>	<ul style="list-style-type: none"> <li>• Limited partnership</li> <li>• Board oversight</li> <li>• Investment committee</li> </ul>	<ul style="list-style-type: none"> <li>• Board</li> <li>• Management</li> </ul>	
<b>Terms and conditions</b>	<ul style="list-style-type: none"> <li>• Long term</li> <li>• Fixed</li> <li>• At-risk</li> </ul>	<ul style="list-style-type: none"> <li>• Long term</li> <li>• Fixed interest</li> <li>• Fee for services</li> <li>• Fixed management fees</li> <li>• Carried interest</li> </ul>	<ul style="list-style-type: none"> <li>• Performance contracts and bonuses</li> <li>• Corresponding loan and equity terms</li> </ul>	<ul style="list-style-type: none"> <li>• Term loans</li> <li>• Graduated guarantees and credit enhancement</li> <li>• Priority lien on receivables</li> <li>• Lien on fixed assets</li> </ul>	
<b>Returns</b>	<ul style="list-style-type: none"> <li>• Blended returns</li> <li>• Priority or preferred return options</li> </ul>	<ul style="list-style-type: none"> <li>• Sustainability</li> <li>• Sunsets</li> <li>• Rollover</li> </ul>	<ul style="list-style-type: none"> <li>• Sustainability</li> <li>• Sunsets</li> </ul>	<ul style="list-style-type: none"> <li>• Performance bonuses</li> </ul>	

## APPENDIX B

**Registration Requirements for a Charitable Organization**

One benefit in the Israeli tax system is the charitable tax deduction available to individuals and corporations. An individual or corporation may contribute up to US\$2 million (approximately NIS 12 million) to a single organization in a single year and claim a 35 percent tax deduction. The organization receiving the contribution must be a registered nonprofit organization by the Registrar of Charities (RashamHa'Amutot) or the Registrar of Companies (Rasham Hachavarot).

Registration as an eligible nonprofit organization involves five steps: (1) an NPO number (MisparHa'amutah) is assigned by the Registrar of Charities to begin the process; (2) a certificate of sound management (NihulTakin) is granted for the first two years of operations, allowing the NPO to obtain government funding and contracts to perform services; (3) a declaration of the NPO as having a public purpose or benefit (MosadTziburi) which exempts the NPO from having to pay taxes on certain investments; (4) a status as eligible to receive tax-deductible contributions from individuals and corporations under Paragraph 46 of the Israeli tax code (Se'if 46); and (5) a license of fiscal approval (Malkar) which allows the NPO to sell goods or services without charging the value-added tax (16 percent).

An alternative way for an NPO to register is through the Registrar of Companies (RashamHachavarot). These companies, referred to as public benefit companies (ChevrahLeto'eletHatzibor), have a different management and ownership structure, must also comply with the registration process described above to receive the special tax treatment (tax-deductible contributions, tax-exempt incomes, exemptions from VAT, etc.)

While the Registrar of Charities or Companies is the official regulator for each of these certificates, the reviews and approvals are recommended by the Ministry of Finance and decided by a special committee of the Knesset (Paragraph 46), making the process of approval complicated and time-consuming. Indeed, according to Guidestar, an online database of NPOs in Israel, 4,280 out of 35,000 (15,000 of which are active) NPOs have a Paragraph 46 certificate.

## APPENDIX C

## Financial Innovations Lab Participants

## Affiliations at the time of the Financial Innovations Lab

**Marc Abramowitz***Private Investor***Zika Abzuk***Senior Manager, Cisco Systems Inc.***Martha Amram***CEO and Founder, WattzOn***Allan Barkat***CEO, Dualis - Israel Social Venture Fund***John Belluomini***Founder and CEO,  
Center for the Greater Good***Eric Benhamou***Chairman, 3Com Corporation***Arthur H. Bilger***Founding Partner,  
Shelter Capital Partners, LLC***Cecile Blilius***Managing Director,  
Impact First Investments***Nicola Cobbold***CEO, The Portland Trust***Abby J. Cohen***Senior Investment Strategist and  
President, Goldman Sachs & Co.***Ronald M. Cohen***Chairman, Portland Trust***Debra England***Philanthropic Consultant***James S. Farley***President and CEO, Leichtag Foundation***Jordan Feder***Principal, Impact First Investments***John R. Fishel***Consultant, Glazer Family Foundation***Alma Gadot-Perez***Director, Milken Institute Israel Center***Alon Globus***CEO, Sona Enterprise***Molly Globus***Director of Public & Community Affairs,  
Aurec Group***Stacy Goodman***Principal, Business Transformations***Lisa Hagerman***Director of DBL Programs,  
DBL Investors***Jonathan N. Hollander***CEO, EvoSpend***Jill Hoyt***Associate Director, Marketing and  
Development, Milken Institute***Eugene Kandel***Head, National Economic Council,  
State of Israel***Carl H. Kaplan***Managing Director, Koret Israel  
Economic Development Funds***Yaron Keidar***Managing Partner,  
Bogot & Keidar Advocates***Jessica LaBarbera***Director, Nonprofit Finance Fund***Shawn Landres***Co-founder and CEO, Jumpstart***Caitlin MacLean***Senior Manager, Financial Innovations  
Labs, Milken Institute***Amit Marom***Founder and CEO,  
Marom Philanthropy & Business Group***Jo-Ann Mort***CEO, ChangeCommunications***Rafi Musher***CEO, Stax Inc.***Sharon Nazarian***President, The Y&S Nazarian  
Family Foundation***John E. Nelson***Co-Director, Wall Street Without Walls***David Pollock***Managing Director, J.P. Morgan***Rae Richman***Director, Rockefeller  
Philanthropy Advisors***Michael Sabel***COO, Stax Inc.***Yael Shalgi***President, Israel Philanthropy***Eyal Sher***Director, Art and Culture,  
The Jerusalem Foundation***Roger M. Stein***Managing Director of Research,  
Moody's Research Labs***Andrew D. Taylor***Executive Vice President,  
Grand Challenges Canada***Adlai Wertman***Founding Director, Society and Business  
Lab, University of Southern California***Glenn Yago***Senior Director,  
Milken Institute Israel Center***Noah D. Yago***Principal, Jerusalem Venture Partners***Steven M. Zecher***Director, Regional Development & Project  
Finance, Milken Institute Israel Center***James H. Zukin***Senior Managing Director & Co-Founder,  
Houlihan Lokey*





## ENDNOTES

1. A summary of the Trajtenberg Report is available at: <http://www.yadhanadiv.org.il/sites/default/files/downloads/resources/Trajtenberg%20Report%20Summary%20-%20English.pdf>. A useful English summary of the report is available at: [http://brookdale.jdc.org.il/\\_Uploads/dbsAttachedFiles/FINAL-Trajtenberg-report-update-December-19-2011.pdf](http://brookdale.jdc.org.il/_Uploads/dbsAttachedFiles/FINAL-Trajtenberg-report-update-December-19-2011.pdf)
2. These data are for non-governmental organizations (NGOs) and nonprofit organizations registered with the Registrar of Charities. They present the majority of social service organizations in Israel.
3. According to a report from the Central Bureau of Statistics, this amount is based on revenues minus expenses for nonprofit organizations in Israel.
4. Globes, November 12, 2012. Available at <http://www.globes.co.il/serveen/globes/docview.asp?did=1000797557&fid=1725>
5. Traditional public schools may not fit into the broad definition of social enterprise here, but charter schools, performance-based schools, and alternative private secondary and post-secondary schools may.
6. In contrast, corporations and partnerships seek to maximize profits. Accordingly, they are subject to corporate taxes and value-added taxes on purchases and sales. At the same time, they are able to depreciate their assets, claiming a portion of the “lost” value against taxable income. NGOs and corporations for the public benefit cannot use the benefits of depreciation.
7. The Grameen Bank of Bangladesh pioneered the concept of social business and defines it as the use of corporate structure and business strategies for social goals. The bank encourages community ownership, does not distribute profits, and generally returns only the initial investment to investors.
8. “A Social Capital Market for Israel: Report of the Working Group for Social Investment,” Elad Katz and Didi Lachman-Messer, March 2012, p 62.
9. <http://www.bigsocietycapital.com/>; <http://www.charitybank.org/>
10. The first social impact bonds were issued in the U.K. in 2010; however, the actual returns are not yet realized on the initial bond series, which are not due until the end of 2012.
11. Report by Stewart Paperin. Milken Institute Global Conference 2012, panel on international development finance.
12. Some social venture capital operators have been deferred their compensation in furtherance of the social objectives of the funds.
13. Katz et al. 2012.
14. VC Policy: YOZMA Program 15-year Perspective, Gil Avnimelech, June, 2009
15. Lab participants noted that new wealth in Israel often comes in the form of sudden company acquisitions, sales, and public offerings in the capital markets. Charitable contributions from the proceeds from these transactions often exceed the limitation on charitable contributions, creating a missed opportunity to secure these funds for social investing.
16. The use of tax credits for a variety of social issues is documented in Katz et al. (2012)
17. The uses and savings associated with tax-exempt debt for nonprofits is described in Katz et al. (2012).
18. Proposed amendment to the Israel Companies Law, (Amendment No. 18), Public Benefit Foundation. First Reading, 2012.
19. According to a survey by Benny Gidron, a leader in research about the social sector in Israel, organizations involved in social activities in Israel are broken down into the following organization types: NGOs: 76 percent; social enterprise: 6 percent; limited corporations: 12 percent; public benefit corporations: 2 percent.





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