Failing Forward

Lessons from Investing at the Edge

ACUMEN
CHANGING THE WAY THE WORLD TACKLES POVERTY

Juhudi Kilimo, East Africa

Contents

Acknowledgments

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Foreword

S4S Technologies, India

Foreword

We started Acumen 22 years ago to change the way the world tackled poverty. We had seen how markets too often overlooked and sometimes exploited the poor; we also saw how top-down aid and charity too often created dependency rather than dignity. Neither of these systems enabled dignity to people living in poverty. Dignity is choice. It is the opportunity to make your own decisions, the feeling of being seen, and the knowledge that you can contribute. Acumen started investing Patient Capital in 2001, philanthropic capital willing to take risks in untested markets, bringing critical goods and services to low-income people and supporting entrepreneurs to scale their businesses.

In order to build a sector that was still resistant to catalytic capital, we also committed to measuring what mattered and to learning from our failures. The financial sector – especially two decades ago – measured only financial returns; charities counted the number of products given away, but not whether lives were impacted in ways that mattered. Acumen took this on by building on our value of "listening to voices unheard" and created Lean Data as a way to measure impact from the perspective of people served. It has been thrilling to see Lean Data influence the impact sector through 60 Decibels, which is led by two former Acumen team members.

Ironically, learning from our failures has taken us longer to institutionalize. We've written internal reports, but haven't shared them with the world. Sometimes, it was to protect entrepreneurs; other times, we were so focused on pioneering all the other aspects of our work. We've integrated some of the hard-earned lessons, but growing standards of excellence requires a more systemic and reflective look across an organization's work. After investing in over 160 social enterprises over two decades, it is time to join other pioneers like SELCO Foundation in analyzing our failures and sharing both how we failed and lessons learned with other impact investors, social enterprises, students, and philanthropists.

For all the work – and money – that millions of nonprofits, social enterprises, philanthropists, and impact investors have deployed in the name of impact, too many inadequate or, frankly, plain out wrong approaches continue to hold back the speed at which we as a world could solve our toughest problems of poverty. Moreover, we're all learning that no single organization is enough: we have to solve our biggest problems together. It is thus imperative that we share, not only our successes, but also our failures and what we learn from them.

This is Acumen's attempt to do just that. We're taking a wide-angle view on some of the models that have failed and sharing what we've learned and how we've changed. We hope it inspires more self-reflection, conversation, and, most importantly, action.

The issues we are trying to solve are urgent. We don't have a lot of time, but we as a world do have the tools and technologies, the skills, the talent, and the capital to solve our toughest problems. But we have to be willing to break away from what we've always done and to lead with moral imagination. We hope you find Failing Forward to be of use, and we look forward to sharing more of our lessons and learning from others as we all do what we can to build the world anew.

Jacqueline Novogratz
Acumen, Founder & CEO

Executive Summary

Juhudi Kilimo, East Africa

Executive Summary

Over the past 22 years, Acumen has invested in 167 companies. About one quarter are our "home runs": both impactful and financially successful. The rest were unsustainable financially, did not have the impact we had hoped, or it is too soon to tell.

This distribution is normal in early-stage investing; a minority of investments provide the majority of returns. Our 2022 report, “Investing as a Means: 20 Years of Patient Capital” showed the results from our investment model, highlighted what we had learned and changed, and explained why we are doubling down on that model in the decades to come.[1] This report: “Failing Forward: Lessons from Investing at the Edge” completes that story. By learning from what has failed, we get smarter at solving problems. No failures would mean we were not pushing hard enough at the edge. It is in our mandate to take risks, and philanthropy enables us to take the risk necessary to realize impact. As an investor trying to tackle problems of poverty, that also means we have an obligation to share what we’ve learned.

Businesses fail for all manner of reasons; but not learning from those experiences would be a greater failure. This report highlights six investments that taught us something about starting, running, and/or investing in social enterprises. Here’s what we learned:

Lesson 1: We need engines, not cogs. A single product may be necessary, but it is rarely sufficient to overcome complex problems. Companies and investors that understand the entire system can deliver the combination of solutions that are needed.

Lesson 2: There is duty and danger in “doing it all.” Early-stage social enterprises need to take on multiple roles: manufacturing, distribution, market offtake, finance. Scaling integrated businesses requires sustainable unit economics and an understanding of the operational drivers of success. Getting there takes patience.

Lesson 3: People cannot buy their way out of poverty. To reach people in poverty with high-quality, affordable services, third-party payors are often necessary.

Lesson 4: Everyone needs to row in the same direction. When stakeholders were not aligned on a vision of long-term success, companies chased short-term growth and ignored key risks. Aligned governance in social enterprise means navigating the tensions between profit and impact.

Lesson 5: Form follows function. Social enterprises need to be structured to attract the type of capital that fits what they do; nonprofits and hybrid orgs can be more effective at channeling resources in certain cases.

Lesson 6: Poverty is not a side project. Organizations that were commercially successful and tried to go down-market were not built to serve people living in poverty. Successful down-market initiatives redesigned operations from the bottom up.

Under each lesson, there are stories of companies that have failed and ways that Acumen has integrated these lessons to try and move forward. Other organizations, like SELCO Foundation, have demonstrated the value of acknowledging failure and learning from it. We are building on that reflective process. Without it, the social impact sector risks becoming a paradox, full of ever-worsening problems but omnipresent success.

It’s uncomfortable to talk about failure, but if we don’t, we miss the opportunity to learn and make real progress towards eradicating poverty. Failure allows us, as investors, and our companies to make wiser decisions. When shared, those lessons can change sectors and systems.

Introduction

Sanergy, East Africa

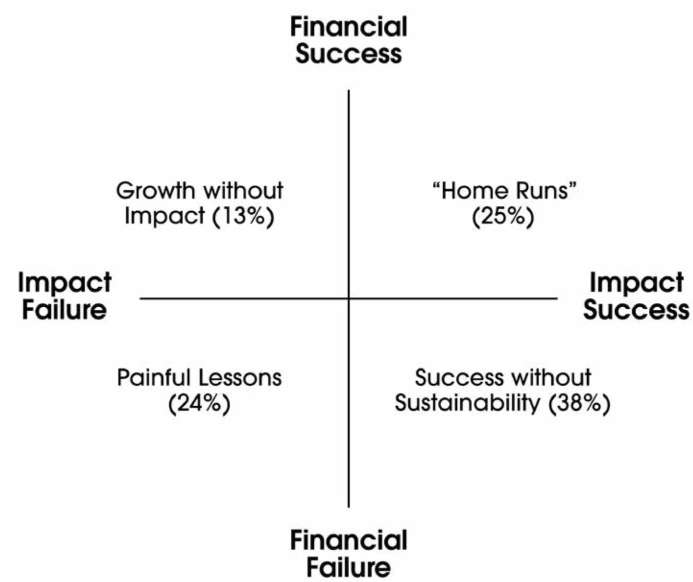
Introduction

Entrepreneurs around the world are building new markets and fixing broken ones, without a roadmap. They are working in regions where the problems confronting people in poverty – lack of essential services, inequitable markets for produce and labor, climate change – are enormous. Businesses that create access, employment, and dignity are necessary, but obstacles are many and success is uncertain.

Acumen uses philanthropy to invest in early-stage companies taking on these problems. **Our mandate is to take risks and to bet on the future.** Inevitably, some of those risks manifest, and some investments fail.

Between 2001 and 2019, we invested in 120 companies. If we make binary judgements about success or failure for impact (did the company make progress against a problem of poverty) and financial sustainability (using return on invested capital as a proxy, with <1x being a "failure"), we see that about one-quarter have been both impact and financial failures, one-eighth have achieved financial success without meaningful impact, and three-eighths have had some impact without achieving financial sustainability. The remaining quarter are our "home runs": impactful, financially successful enterprises.

This distribution of results is not unusual in early-stage investing: one researcher estimated that 60% of venture capital-backed startups[2] failed to return investors' capital. **But too often, we have failed to talk about failure**, about lessons learned from the investments outside of that top-right quadrant. Yet it was those experiments that made us wiser about what works when creating and investing in businesses that reduce poverty.



This report is meant to share our lessons with wider audiences:

Social Entrepreneurs: Guidance on how to build an offering and an enterprise to most effectively address big problems.

Investors: The folly of one-size-fits-all investment approaches and provides an alternative path for allocating capital to tackle systemic issues.

Philanthropists and Capital Providers: The critical role that philanthropy and concessionary capital can play to enable experimentation, learning, and innovation.

What Is a Failure?

We define a failure as *any investment that did not achieve meaningful impact against the problem it set out to address*. That failure may be the result of financial issues (inability to grow, insolvency), or it may be caused by other factors, such as a pivot away from the original impact focus. This definition centers the "impact" we seek to create: **if an investment produced a return but changed nothing for people in poverty, then we cannot consider it a success.** The failure is also specific to our investment thesis; the company in question may or may not still be operating.

Businesses fail for all manner of reasons, and in our portfolio, many of the causes are the same as in any other sector: poor cash management, lack of product-market fit, or macro factors like foreign exchange. Even the weather plays a role. But case studies and roadmaps already exist for these problems; we won't recreate them here. **Instead, this report looks specifically at failures that taught us something about starting, running, and/or investing in social enterprises.**


Kentaste, East Africa

Other industries have demonstrated the value of this reflection. The airline industry reduced the fatality rate of flying by 96% from the 1970s to today, in part by embracing errors as a source of data and destigmatizing them. As long as an error is reported, the reporter faces no risk of being terminated or demoted.[3]

Organizations such as SELCO Foundation have worked to bring this discipline to social impact. We are building on that reflective process. Without that, **the social impact sector risks becoming a paradox, full of ever-worsening problems but omnipresent success.**

This report summarizes the lessons learned from analyzing over two dozen failed investments. We interviewed 30+ investors and entrepreneurs, analyzed investment memos and reviews, reviewed financial statements, and listened to what customers told us at the time. We have drawn out six key lessons from Acumen's failed investments, which are explored in depth below, along with accompanying case studies and recommendations for social entrepreneurs, investors, and philanthropists. Investee names are anonymized throughout this report, except where the company has provided its permission to be named or the information is publicly available. For each lesson, we also show how Acumen adapted in the wake of these failures and endeavored to become wiser.

Two important caveats before we outline the lessons:

1. **Failure is an opportunity to learn, not a license to do harm.** Experimenting with products and services for people in poverty brings with it a special duty of care; you don't get to "move fast and break things." It is important for us to try new things and learn from challenges, but investors and entrepreneurs must avoid putting people or their long-term livelihoods in jeopardy.

2. **Social enterprises operate on a razor-thin margin for error.** The overwhelming majority of Acumen's unsuccessful investments failed not because of carelessness or malice, but because this work is difficult. The women and men who devoted years of their life to the pursuit of social improvement deserve to be commended, whatever the result, and these lessons are a testament to their efforts.

This is a process, not a destination. And it's one we plan to repeat; analyzing past failures does not protect us from committing new ones. But our hope with this project is that we, and others, ensure that future failures are the product of innovation and experimentation, of pushing further and learning from what we have tried.

Lesson 1: We need engines, not cogs.

Gulu Agricultural Development Company, East Africa
Photo by: Todd Shapera

Failure: A single product may be necessary to tackle complex problems of poverty, but it is rarely sufficient.

The lure of simple, straightforward solutions is strong in our work. But problems of poverty persist because of complex webs of needs and interests. Improving one widget or **optimizing one link in the value chain may be important but is often insufficient.**

In 2013, we invested in "AgInfo," an agribusiness that provided market information to smallholder farmers. Farmers saw value in this product, and were able to make better, informed decisions. One customer stated, "now I am able to save my chicken because of the advice I get."

Despite the positive feedback, farmers overwhelmingly noted an important missing piece: direct market access. Another customer stated, "my only request is that you provide a buyer as I have many chickens and no one to sell to." Customers valued the service, but they were not willing to pay for it unless it came bundled with a willing buyer. The company struggled for years to build partnerships with third-party payors.

AgInfo was one of several agricultural companies that Acumen invested in that provided smallholder farmers with a single improved input, such as seeds, irrigation, or fertilizer. Our theory was that improved inputs would lead to increased yields and therefore increased income. The reality was that better inputs could increase yields, but those yields had nowhere to go: Farmers did not have someone willing to buy more of their produce, or pay a premium for higher-quality output.

Several of these companies had some financial success, but none created the outcomes we had hoped for. Increased yields were important, but not sufficient: Farmers needed market access. And we needed a more holistic approach.

Forward: Systems change requires systems knowledge.

One of Acumen's most valuable lessons from these failed investments is the importance of understanding the entire system of a problem, not just the pieces of it where our companies operate. We see the most impact from companies that are able to address the multiple, overlapping needs of customers. This comes from either integrating multiple functions into their business models or partnering with someone who can complement their product or service.

In agriculture, we have seen that single input companies do not drive impact. Instead, companies that integrate market access, in addition to inputs and advisory services, are better suited to manage risk, coordinate distribution, and improve the incomes of farmers. For example, Gulu Agricultural Development Company (GADC) provides local smallholder farmers in Uganda with inputs and training, then purchases cotton from those farmers. GADC's integrated business model helps them to achieve sustainable growth and scale, and more importantly, provides farmers with a reliable source of income.

Similarly, investors need to take larger systems into account when they devise their investment strategies and evaluate individual deals. KawiSafi Ventures, for example, is an early growth-stage venture capital fund that was developed by Acumen. It seeks to catalyze growth in the clean energy access sector by investing along the value chain: from manufacturing to financing to software to distribution. System-level investing is a strategy that examines the parts and relationships of a system and adapts processes and tools to bolster weaknesses in the system to strengthen the whole. Organizations like the Global Impact Investing Network (GIIN)[4], Enclude[5], and the Investment Integration Project (TIIP)[6] have shown the impact of such practices.

For companies, the upshot is that when deploying a product or service within a broken system, they may end up needing to do more than they intended.

We see the most impact from companies that are able to address the multiple, overlapping needs of customers.

ENTREPRENEURS

Map out the entire system that your organization plans to operate in. Understand the gaps and stakeholders, what links in the value chain you may need to fill, and where you can partner.

INVESTORS

Start with an intended outcome, then map the relevant systems to arrive at an investment thesis.

Understand where your capital is appropriate, and where you may need a new approach.

Help investees bring together the functions and partnerships that will help them achieve their goals.

PHILANTHROPISTS & CAPITAL PROVIDERS

Look for investment vehicles and organizations that demonstrate a system-wide knowledge.

Help address gaps through catalytic capital.

Lesson 2:
There is duty and danger in "doing it all."

S4S Technologies, India

Failure: When companies tried to scale complicated models prematurely, they scaled their problems instead.

Selling a product or providing a service to people living in poverty requires companies to integrate different functions (e.g., training or market offtake) to overcome barriers to adoption. These added functions create complexity, meaning that businesses require sophisticated management and have high costs. Scale is needed to make these models profitable, but companies cannot push to scale before they have untangled the complexity. This may sound obvious, but it's a mistake we have seen many social entrepreneurs make, often because they committed to rapid scale in order to raise money. One agricultural company we invested in ("GrainCo") built a central farm, then worked closely with local smallholder farmers, improving their yields through agronomic support and higher-quality inputs. The company would then buy and process their grain at a third-party mill, before packaging and selling in local markets as a premium-branded product, replacing imported grain and guaranteeing a more stable price.

Initial yield increases at the farmer level were promising. But the only third-party mill available proved unviable: the operators shifted prices frequently and a disturbing amount of product was lost or stolen. GrainCo decided to build its own mill, internalizing even more of the value chain and building up more debt within the business.

Photo by: Pixabay

Financial projections indicated that the business could service its level of debt if it increased mill utilization to optimal levels. GrainCo began growing its farmer network to acquire more grain, increase uptime, and thereby, increase sales. But the company repeatedly missed its projections. GrainCo could not service its debt and other costs with its revenue and ended up scaling a growing deficit.

GrainCo did not adequately understand or track the operating metrics that drove profitability. A key example was uptime of harvesting machinery: to conserve cash, the company purchased used harvesters, with little provision for parts or training of maintenance staff. But those harvesters were out of commission a majority of the time, which meant the company could not hit its throughput targets. Larger investors grew impatient with losses and pushed for a distressed sale to another firm.

The Risk of Doing It All While Trying to Grow

The first culprit here was the sheer scope of what GrainCo was doing. A general list of functions within the business (leaving out internal processes like finance) included:

- Identifying, recruiting, and training farmers
- Providing inputs (seed, fertilizer)
- Planting, growing, and harvesting grain on its own farm
- Sourcing and transporting grain from outgrower farmers
- Milling and packaging
- Storage
- Marketing and distribution

In more specialized sectors, that could be the work of five companies, with extension services and government subsidies added in. GrainCo was filling every gap on its own, because it had to. As the milling example shows, there were few viable partners; integration was the only way it perceived that it could deliver value.

Making that integrated model work requires a thorough understanding of operational drivers of success (such as harvester uptime) and unit economics (e.g., the cost of equipment maintenance per kg of grain sold). These complex business models benefit from experienced managers, which companies are not always able to afford.

Integrated models can work, given time. But in GrainCo's case, a premature decision to scale, driven in part by pressure from impact investors and private equity, exploded the company's problems. The push for scale is understandable: problems like rural poverty are immense, and impact investors are looking for solutions with commensurate breadth. But these are asset-heavy, complicated businesses that take time to get right, and time to grow. Nor is the alternative – small-scale, impactful work – appropriate for every problem. Social enterprises are asked to do everything, and to be everywhere, fast.

Forward: There is no escaping this dilemma; the only way is through.

If the answer to both impact and profitability is scale, then that scale can only come when companies understand their unit economics and can control the key drivers of operational success. That takes time, talent, and experimentation, hence the need for Patient Capital.

S4S is a company that is in the midst of scaling an operationally complex model. They sell solar conduction dryers to micro-entrepreneurs (MEs) in rural India. Those MEs then use the dryers to dehydrate produce that is sourced from local farmers (with the help of S4S). Once things like onions, ginger, and pulses have been dehydrated, S4S purchases them from the MEs and sells them to large-scale buyers. This model combines asset manufacturing, sales and distribution of the dryers, sourcing of produce, logistics, offtake, packaging, and distribution of dehydrated produce.

Nidhi Pant, one of the co-founders and head of finance and partnerships of S4S, reflected: "So many people told us there were too many points of failure in our model to actually make it scale…Raw materials might not be delivered, weather, bank funding would not be ready, quality of product did not match quality the market demanded."

But S4S has been able to overcome those barriers through:

1. **A clear focus on their operational drivers.** The utilization of the solar conduction dryers is the determining factor of S4S' success. When it was too low in some newer sites, S4S began taking a more hands-on role in sourcing produce and bringing it to the MEs, which expanded the reachable supply of produce.

2. **Partnerships.** Just because a social enterprise must do many things does not mean they must do everything. As sectors develop, they tend towards specialization, and successful companies seek opportunities to outsource non-core functions. S4S has partnered with the Bank of Maharashtra and State Bank of India to finance its solar conduction dryers. This makes the dryers affordable for MEs and takes challenging processes off S4S' hands. Not every company has these opportunities, but they may do well to seize them wherever possible.

Kheyti, India

Social enterprises end up doing more than they expect. It is a herculean task to properly execute complex business models. Success comes slowly, by understanding (through trial and error) which parts of the business demand focus.

If the answer to both impact and profitability is scale, then that scale can only come when companies understand their unit economics and can control the key drivers of operational success.

ENTREPRENEURS

Identify the operational drivers of success, measure them rigorously, and do what is needed to optimize. Work out the unit economics to ensure that margins can support complex operations.

Seek partnerships for non-core functions.

Pilot and monitor expansion before shifting to growth mode.

INVESTORS

Set realistic expectations for the growth rates of integrated models.

Work with investees to help them understand and measure their operational drivers and unit economics.

Facilitate partnerships for investees.

PHILANTHROPISTS & CAPITAL PROVIDERS

De-risk returns and enable more patience through catalytic uses of philanthropy. Limited partners' (LPs') capital drives return expectations and timelines.

Lesson 3: People cannot buy their way out of poverty.

Photo by: Kampus Productions

Failure: Entrepreneurs assumed that people in poverty would be able and willing customers.

When working with people living in poverty, social enterprises understand the importance of making a quality product and making that product affordable. What's less obvious is how much customers are willing to pay and who is willing to subsidize the cost to make products affordable.

Acumen invested in "HealthCo", a company that provided holistic services through diet, lifestyle, and treatment procedures for patients of chronic ailments such as diabetes and arthritis. HealthCo combined a low-cost, service-delivery model, cross subsidization through a tiered-pricing model, and partnerships with leading insurance players to make its services affordable.

Yet in the end, the service-delivery model was unsuccessful in attracting low-income customers. Footfalls were low, costs were unsustainably high, and the company simply could not attract the quantity of low-income customers necessary to justify maintaining the model. The average patient needed to return 16 times per month to receive the prescribed treatment, a cost in time and money that few patients could afford. The company eventually closed this area of its business and focused on higher-end customers who had the time and money to avail themselves of the services.

All businesses work to meet the needs of their customers, but it is significantly more difficult for social enterprises that are trying to reach people living in poverty. Social enterprises still need to create a quality product or service, but they also work within challenging realities around pricing and priorities. Low-income consumers operate on tighter constraints; they cannot afford riskier investments that may or may not pay off in an uncertain future. HealthCo created positive health outcomes; but few people who needed them were willing to pay.

To realize goals of both impact and long-term financial sustainability, products must be both valuable and affordable to low-income customers. This is not easy to do, and relying wholly on end-user payments shrinks the window for innovation. Reaching low-income customers requires answering a critical question: *who pays?*

Forward: If the user cannot pay, find another way.

Acumen began our journey focused on finding businesses that would serve people living in poverty as customers. Over time, we learned the limitations of that mindset. Not all impactful business models are direct-to-consumer businesses, where a customer pays 100% of the cost. **Expecting people in poverty to pay their way out overlooks their realities**, especially when we are trying to reach populations that have difficulty accessing basic goods and services.

Beyond traditional commercial models, Acumen has invested in two alternative models of scalable, sustainable solutions to reach people in poverty: a third-party payor on behalf of low-income customers; and hybrid models that include long-term grant funding alongside a revenue-generating business.

Upward Health provides high-quality, coordinated care to Medicaid and Medicare patients through an enterprise buyer model in which a third party, such as employers or insurance companies, will pay on behalf of the end-user. Everyone values quality healthcare, but each person's ability and willingness to pay varies. Upward Health was able to identify and partner with enterprise buyers that bore the cost of treating low-income, uninsured patients in emergency rooms. They used those partnerships to fund high-quality at-home care for vulnerable patients, while reducing overall costs for their partners.

Returning to the case of Gulu Agricultural Development Company (GADC), we've seen the power of leveraging grant finance to serve smallholder farmers in Northern Uganda. In addition to market access, GADC provides inputs, outreach, and training, which includes helping farmers become certified as organic. However, these support services often do not always generate enough revenue to cover their costs. So, the company sought out grants to help pay for these services. DANIDA, the Danish development agency, provided one such grant that enabled GADC to embed farmer training into its model.

As we discussed in our report "Investing as a Means," **the question of "who pays?" is one of the key questions that a company serving low-income communities must answer.** Building partnerships that enable access and affordability is patient, difficult work. But we have seen that the companies which succeed tend to have outsized impacts on people living in poverty.

Not all impactful business models are direct-to-consumer businesses, where a customer pays 100% of the cost. Expecting people in poverty to pay their way out overlooks their realities.

ENTREPRENEURS

Put prototype offers in front of actual customers as quickly as possible to test their ability and willingness to pay.

Map out the stakeholders and understand who could benefit from an improvement to the status quo.

Partnerships take years; begin conversations as soon as possible with third-party payors.

INVESTORS

B2G and B2B2C offerings have well-established risks; work with investees to help them build partnerships while still mitigating and diversifying risk wherever possible.

PHILANTHROPISTS & CAPITAL PROVIDERS

Consider funding pilots of quasi-government interventions. Successful government partnerships can bring widespread scale for critical services. But governments need data; pilot interventions can help build a track-record.

Lesson 4: Everyone needs to be rowing in the same direction.

BURN Manufacturing, East Africa

Failure: When stakeholders were not aligned on a vision of long-term success, companies chased short-term growth and ignored key risks.

Social enterprises have multiple stakeholders: investors, board members, staff, even customers. **Success requires those stakeholders to be aligned on a long-term vision, which may include a balance between impact and profit.** Navigating complexity and options on the way to that vision is the job of a board. But equity investors tend to be impatient optimists; a necessary trait, but one that can lead us to underestimate the risks and time required to build a lasting solution.

We invested in and held a board seat with an asset company ("AssetInc") that combined the distribution and sale of durable goods with credit to make those assets affordable to low-income households. The company understood the importance of credit and had built a risk management discipline that worked well with a small base of customers. Eventually, the company's leadership decided it was ready to grow the company. It raised a significant round of equity investment, in part by promising to scale up operations, including moving into a neighboring country.

In the space of three years, AssetInc's staff grew from 200 to 1,200 people. Its Board was excited about sales and expansion. Credit risk management was an inherent part of the business, but it was deprioritized to achieve that growth. While the organization's headcount grew sixfold, the credit team only doubled.

The rate of sales grew sharply, but portfolio quality began to deteriorate. Credit metrics were reported at quarterly meetings, but they were not prioritized. In asset finance, the assets themselves serve as collateral for the loan. As repayment rates dropped, customers who could not pay saw their assets repossessed. They did not reap any benefit from the company. If anything, they were worse off.

Within AssetInc, there was a fundamental misunderstanding of what success looked like. Stakeholders, including both management and the Board, prioritized top-line growth over credit quality, and that damaged the long-term goals of the company. Investors had wanted to see growth because they were looking for wide-scale impact. But increased sales did not lead to improved outcomes for households, and the company rapidly contracted.

Forward: Aligned governance in social enterprise means navigating the tensions between profit and impact.

Good governance involves establishing the people and systems within a social enterprise to balance profit and purpose. Investors and board directors play a role in building up that foundation. Success requires a shared commitment to the vision of the enterprise, to its impact and its sustainability. A strong board:

- Supports founders as they build up their team and their capabilities
- Helps to hold founders accountable to their goals
- Navigates long-term risks and opportunities
- Enshrines the organization's vision in the DNA of the company

This was the case for BURN Manufacturing, a manufacturer of improved cookstoves. Two years into our investment, the company was deciding how to pursue scale: whether to continue prioritizing low-income customers or to pivot to a potentially easier path through an up-market play. Its Board recognized the ongoing potential of the company's products to impact people living in poverty and encouraged the CEO's desire to commit to that market segment. With support from its Board, BURN was able to scale its operations serving low-income households. Both the Board and the company played their respective roles; the Board was a guide and an advisor, while the company successfully executed on their mission-driven business plan.

The balance between impact and financial viability is difficult to navigate for all stakeholders of a social enterprise. It is impossible to guarantee a working relationship that responds "correctly" to differences and disagreements 100% of the time. But aligned stakeholders within a strong governance structure can understand those tensions and navigate the tradeoffs that are bound to occur.

Good governance involves establishing the people and systems within a social enterprise to balance profit and purpose.

ENTREPRENEURS

Find early-stage investors who understand your vision and believe in it.

Appoint directors who are prepared to navigate the tensions of scaling a social enterprise.

Under-promise and over-deliver. If you promise exponential growth and cannot achieve it with your model, investors will (rightly) push you upmarket to find growth.

INVESTORS

Pre-investment, understand the founder's vision for impact and sustainability.

Insist on growth that results in long-term value, not short-term reward.

Work with a management team to ensure that they can measure what matters, and communicate it to the board regularly.

PHILANTHROPISTS & CAPITAL PROVIDERS

Support alignment by being vocal about the importance of social impact goals.

Provide financing that enables the patience, impact measurement, and business practices that can help a social enterprise achieve success.

Lesson 5:
Form follows function.

Sanergy, East Africa

Failure: Every attempt to change the structure of an organization has failed.

When Acumen was initially pursuing only direct-to-consumer businesses, we had one idea of what a social enterprise ought to look like: a for-profit company that would grow quickly, raise commercial capital, then achieve widespread scale and impact. But in the first decade of Acumen's operations, few companies in our portfolio met that description. So, we started to invest in models from nonprofits or charities with some element of a market-based solution. Then we tried to change them.

With "HospiCo", we funded the creation of a for-profit corporation that would run a chain of specialized hospitals. The entrepreneur had previously run nonprofit hospitals, but we believed that a for-profit approach could generate positive cash flow and scale. The investment memo read:

"There is an opportunity … to use our Patient Capital to prove that healthcare investments can be structured to secure good returns for investors while focusing on the low-income market."

We underestimated the costs of establishing accredited hospitals, and low-income customers' willingness to pay full price for health services (see Lesson 3). Just as important, the founder of the company did not see end-user revenue as a key aim: they were able to address the needs of their customers through government subsidy and by providing camps where customers could access basic services for free.

The company achieved its social impact by providing health services to poor people, but it was unable to grow beyond its first hospital. Meanwhile, customers were unwilling to pay given the availability of services outside of the hospital setting.

There was never proper alignment between Acumen and the promoter. Despite being upfront over our Patient Capital model, the entrepreneur was used to doing business in a certain way. They were surprised to see Acumen pushing for scale, profitability, and an eventual exit, and were unwilling to restructure operations around those goals.

Organizational structure is partially driven by values, but mostly by practicality. HospiCo's original organization was set up to provide services to people who could not pay for them, and to raise grants or government funds to make up the difference. To try and change it quickly, forcing a square peg through a round hole, led to failure.

Forward: There is not one right way to build an enterprise. Social enterprises should be structured to attract the type of capital that fits what they do.

By trying to change an existing nonprofit into a market-based solution, we failed to internalize what made the nonprofit successful in the first place. Rather than try to force a strictly for-profit approach onto a mission-driven organization, we learned to invest in appropriate organizational structures.

The Sanergy Collaborative, as highlighted in our "Investing as a Means" report, is comprised of two partner organizations – a nonprofit entity (Fresh-Life, which provides urban sanitation) and a for-profit entity (Regen Organics, which upcycles waste into fertilizer and other products). Within the nonprofit entity, there are multiple revenue streams: user payments, grants, and municipal government contracts combine to make Fresh-Life sustainable. Regen Organics off-takes waste from Fresh Life as well as organic waste from markets, agribusinesses, and central kitchens and processes it into organic fertilizer and insect protein, which are then sold to farmers, thereby creating positive social impact and financial viability.

Kheyti is a company with a market-based solution: a greenhouse-in-a-box that enables farmers to become resilient to rising temperatures and volatile climate conditions. But Kheyti is structured as a nonprofit, because that enables the company to raise sufficient grants for research, development, and product iteration. BURN and M-KOPA are structured differently, although they have a similar purpose: both feature a for-profit company and a nonprofit "Lab" that raises grants for R&D.

Sanergy and Kheyti may not conform to the traditional notion of a startup, but they align with the practicalities of their solutions: markets where the payment capacity of users cannot sufficiently cover the costs of capital expenditures and research, respectively. Their structures enable them to optimize their impact. Square pegs, square holes.

Rather than try to force a strictly for-profit approach onto a mission-driven organization, we learned to invest in alternative organization structures.

ENTREPRENEURS

Don't limit yourself upfront. Build a financial model that is realistic and appropriate for your intervention.

If the numbers do not add up to commercial returns, explore roles for subsidies or grants, and structure your organization to attract those.

INVESTORS

Be open to innovation. Hybrid organizations can address deep problems of poverty while still providing returns. Understand where your capital fits and explore alternative instruments.

PHILANTHROPISTS & CAPITAL PROVIDERS

Explore blended finance options. Enterprises like Sanergy or One Acre Fund that blend grants and user revenues offer strong potential for leverage, sustainability, and impact.

Lesson 6: Poverty is not a side project.

Failure: Companies who dabbled in serving people living in poverty left as quickly as they came.

The "fortune at the bottom of the pyramid" has intrigued companies, even before the term was codified by Prahalad and Hart in their 2002 article,[7] which began by saying: "The real source of market promise is not the wealthy few in the developing world, or even the emerging middle-income consumers. It is the billions of aspiring poor who are joining the market economy for the first time."

Historically, Acumen has experimented with investing in larger companies that wished to go down-market. FamilyCo was one case: the subsidiary of a family-owned conglomerate which had multiple profitable businesses serving public entities and urban households. One of the family members wanted to expand into more rural, direct-to-consumer offerings that would benefit people living in poverty, and Acumen invested in that vision. We were attracted by the chance to work with a profitable company that could cross-subsidize lower-margin customers on its way to scale.

Within a year there were troubling signs. There had been only one Board meeting, and little information was shared with Acumen. The company expected hands-on support in developing its direct-to-consumer (D2C) business, beyond what Acumen could provide. Within three years the company pulled its D2C offering, having sold only 3,000 units. The initial commitment may have been sincere, but the company was not prepared for the long-term investment and challenge of serving hard-to-reach households and building partnerships to scale. It prioritized its established, profitable business lines, and stayed up-market.

There have been cases of large companies that have profitably served people in poverty. But they did not do so with the same margins or growth rates that they expect from other business lines, and significant early investment was often needed. Building markets to serve low-income communities requires a different approach.

Forward: Organizations that are designed from the problem up can achieve greater impact.

These markets are unique and therefore present unique challenges. **In many cases, the best way to serve people living in poverty is to design an operation from the ground up.** We have seen successful cases of established organizations incubating new enterprises that have different goals and approaches but retain some of the parent's DNA.

K-Rep Bank is one such example. The bank was started in the 1980s as a development project, but by the early 2000s had evolved into a full-service microfinance bank. Yet the company did not have a viable product for lending to the informal agricultural sector, which makes up a sizable portion of the Kenyan economy. To address this, the bank developed a loan product that streamlined processes and worked through farmers' groups, similar to Grameen Bank's lending model in Bangladesh.

Once the product had been proven viable, K-Rep incubated an organization to run it. They quickly realized that although the product was profitable and viable, it would require a separate institution to secure substantial funding, while operating with reduced expenses and different risk criteria. K-Rep spun off an organization that became Juhudi Kilimo, and Acumen and others invested soon after.

Prahalad and Hart themselves acknowledged what we have found to be true: **"Serving [people in poverty] is not the same as serving existing markets better or more efficiently. Managers first must develop a commercial infrastructure tailored to the needs and challenges" of their new customers.**

In many cases, the best way to serve people living in poverty is to design an operation from the ground up.

ENTREPRENEURS

Leave out the legacy; if you are starting to serve low-income segments, be prepared to redesign how you operate, and build a commercial infrastructure around the margins that those customers support.

INVESTORS

Be wary of the lure of expertise. Proven operators are needed, but the skills and structures of a successful company will not translate down-market without change. Be as rigorous with such opportunities as you would with a start-up.

PHILANTHROPISTS & CAPITAL PROVIDERS

Whether working with a large or small company, bring Patient Capital that enables businesses and investors to innovate, iterate, and build markets over time. Larger companies may need to carve out opportunities and subsidize them internally before they become commercially viable.

Recommendations

BURN Manufacturing, East Africa

Recommendations

These represent some of the valuable lessons Acumen has learned through 22 years of Patient Capital investing, and we know that there are more ahead. We have shared our bruises, and the lessons we have learned from them, to help others avoid similar mistakes. Looking forward, here are guiding questions and recommendations we want entrepreneurs, investors, and philanthropists to take note of.

When building a social enterprise:

A

Understand all sides of the problem.

B

Learn the fundamentals of your business.

C

Figure out who pays.

D

Ensure all stakeholders are aligned on a vision.

E

Design the enterprise to raise the right kind of capital.

F

Build the organization around the problem.

Entrepreneurs

We have seen that **impact comes when an entrepreneur starts with a clear understanding of a problem**, iterates on solutions that can fill the gaps, then builds an organization or network of partnerships that can raise capital to implement those solutions.

- **Map out the entire system** that your organization plans to operate in. Understand the gaps and stakeholders, what links in the value chain you may need to fill, and where you can partner. Try to focus. Look for companies who can cover non-core functions.
- **Identify the operational drivers of success, measure them rigorously, and optimize.** Work out the unit economics to understand how the margins support your whole operation.
- **Figure out who pays.** Test customers' ability and willingness to pay as soon as possible. If they cannot pay the all-in costs, explore the universe of alternate payors: who would benefit from your impact? Partnerships take years; start early.
- **Find investors who share your vision.** Appoint directors who are prepared to navigate the tensions of scaling a social enterprise. Under-promise and over-deliver: what you say when raising money will affect your relationship going forward.
- **Don't limit yourself to a structure upfront.** Build a financial model that is realistic and appropriate for your intervention. If the numbers do not add up to commercial returns, explore a role for subsidies or grants, and structure your organization to attract those.
- **Be prepared to redesign how you operate** if you are expanding to serve low-income segments. Start from the bottom up: build a commercial infrastructure around the margins that those customers support.

Investors

One of the overriding themes of this report is the folly of starting with a hammer and looking for a nail. **We need more solutions-oriented investors** who start with a desired outcome and can bring together the right types of capital and instruments to achieve it.

- **Start with the desired outcome,** then map the relevant systems against your capabilities to arrive at an investment thesis. Understand where your capital is appropriate and where you may need a new approach.
- **Set realistic expectations** for the growth rates of integrated models. Where possible, help to outsource non-core functions to partners.
- **Understand the balance between impact and sustainability** and evaluate if that fits with your approach. Insist on growth that results in long-term value and ensure that management can measure what matters and communicate it to the board.
- **Be open to innovation in organizational structure.** Hybrid organizations can address deep problems of poverty while still providing returns. Understand where your capital would fit in those structures and explore alternative instruments.

In addition: as investors seeking to drive social change, we need to reflect on failed investments, draw out the important lessons, then share more with each other about what has not worked, and what we have learned from the experiences.

At Acumen, this report has led us to adopt processes for reflecting on failed investments. This moves past our traditional documentation to dig deeper into what happened, what were the root causes, what we could have done differently, and what we'll change going forward. We are also making those reflections accessible for our portfolio managers across regions, to help us learn and grow as an organization. And we are sharing key lessons learned through reports like this one.

Philanthropists and Capital Providers

This is difficult, necessary work. We need tens of thousands more social entrepreneurs to take risks on models that serve people living in poverty, and billions more in capital to fund those experiments. But we have seen that not all those bets will pay off, and even the ones that do may not have venture capital-like financial returns. Instead, the most successful enterprises find partners that value both financial viability and meaningful social impact. The social returns that come from supporting social enterprises are enormous, and the role of philanthropy in achieving this impact is fundamental.

The actors who can make the greatest difference in encouraging more risk-taking are philanthropists. **Philanthropic capital, if deployed with trust and a clear alignment on outcomes, can give investors and entrepreneurs the freedom to innovate, fail, iterate, and ultimately succeed.**

- **Find people who understand the system.** Look for investment vehicles and organizations that demonstrate a system-wide knowledge, then help address gaps through catalytic capital.
- **Enable more patience** through catalytic uses of philanthropy. Limited partners drive fund behavior; philanthropy can enable investors to be patient and focus on outcomes.
- **Help build track-record.** Third-party payors can bring widespread scale for critical services. But governments and others need data; funding pilots of interventions that require a third-party payor can help demonstrate results.
- **Blended capital, everywhere.** Enterprises like Sanergy or One Acre Fund that mix grants and user revenues create potential for leverage, sustainability, and impact.

Conclusion

Kheyti, India

Conclusion

If failure is not an option, then neither is success. From the beginning, Acumen's promise has been to use philanthropy to take big risks on innovations that could help the poor. When those risks have paid off, we celebrate successes. When the risks manifest themselves, we learn, become wiser, and try again.

We would not be where we are today without the lessons we have learned along the way. And if some of those lessons were painful, that is its own reminder of how much we care about this work.

We are deeply grateful to the entrepreneurs who took on these challenges, and our partners who made this work possible. This report, in particular, would never have been possible without the power of philanthropy to catalyze innovation. **We could never have taken the risks we did, nor developed the insights we have, without the freedom to try, fail, and learn.** We look forward to sharing more stories of our successes and our lessons learned.

Juhudi Kilimo, East Africa

Endnotes

1 Acumen (2022) *Investing as a Means: 20 Years of Patient Capital*

2 Ghosh S, Nanda R (2010) *Venture Capital Investment in the Clean Energy Sector*

3 Freakonomics (2023) *Why is Flying Safer Than Driving?*

4 Global Impact Investing Network (2021) *Warriors and Lovers: Systemic change requires diversity in strategies, too*

5 Enclude (2019) *Systems Change: An Emerging Practice in Impact Investing*

6 The Investment Integration Project (2022) *System-Level Investing*

7 Hart S, Prahaland C.K (2002) *The fortune at the bottom of the pyramid*

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