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Vox Capital: Pioneering Impact Investing in Brazil

Antonio Ermirio de Moraes Neto, 30, co-founder of Vox Capital, had just stepped into his office in São Paulo when the phone rang. "We cannot postpone finalizing the Fund II investment thesis any longer. We should agree on next steps at our partner meeting this afternoon," remarked Daniel Izzo, 41, co-founder and CEO of Vox. On the other end of the phone, Antonio mentally prepared. As an impact investing fund manager in Brazil, Vox provided early-stage capital for companies offering innovative and scalable solutions to enhance the lives of low-income Brazilians, while simultaneously generating attractive market-rate financial returns for investors. Antonio, Daniel, and Kelly Michel, 36, had founded Vox in 2009, when only a couple of firms seeking joint financial and social returns were investing in the country. Eight years later, in 2017, the impact investing sector was still nascent but attracting more attention[a] in Brazil and around the world (see **Exhibit 1** for background on the spectrum of hybrid investing).[1]

Brazil made significant strides against inequality in the 2000s and early 2010s with a booming economy, raising 40 million people out of poverty.[2] However, around 80% of its population still earned less than US$9 per day,[3] and the country remained one of the most unequal in the world.[4] In 2015 and 2016, Brazil experienced its worst recession in twenty years,[b] with rising unemployment,[5] inflation, steep currency devaluation, and slashes in government social programs.[6]

In this precarious context, Vox not only faced all the issues of a traditional fund manager—with fundraising, deal flow, and risk management—but also confronted uncharted challenges as it pursued a dual, social and financial, bottom line. There were no clear barometers for the meaning and

[a] There were 3 active impact investors in Brazil in 2007 and 29 in 2016, of which 13 were Brazil-focused and 16 international investors. Seven investors reported combined US$186 million of assets under management. Source: Aspen Network of Development Entrepreneurs, Latin American Private Equity and Venture Capital Association, and LGT Impact Ventures, "The Impact Investing Landscape in Latin America," Survey Report, August 2016.

[b] The gross domestic product historical series, calculated by the Brazilian Institute of Geography and Statistics, started in 1996.

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significance of positive social impact, let alone agreement on how to balance a social mission with financial viability.

Vox already attracted international recognition, with the *Financial Times*, World Economic Forum, and *Forbes*[7] featuring Antonio in 2013 as "one of 25 Brazilians to watch"[8] and as a visionary entrepreneur who had brought the concept of impact investing to Brazil. However, as Vox raised money for its second fund in 2017, its partners continued to revisit their practices and premise. What social impact was the firm generating? What funding sources best matched Vox's dual objectives? Did Vox's investment deal structures protect its interests as well as those of the hybrid enterprises—pursuing social and commercial goals—in which it invested, or did they reproduce the inequalities Vox was trying to address? Was the company walking its talk in its own operations? As a role model, how cautious should Vox be managing investment risks? All these questions remained open for Antonio and Daniel as they approached the partner meeting to decide the fundamental set of beliefs underlying Fund II.

Exploring the Social-Commercial Nexus

Although Antonio had become a poster child for impact investing, for many Brazilians his name would ring a bell for another reason. His family controlled the Votorantim Group, Latin America's fifth-largest industrial conglomerate, which included cement production, pulp and paper, aluminum, energy, and financial services. Antonio bore the same name as the man credited for scaling the US$40-billion business, his paternal grandfather, who was also known for his devoted volunteering and humble lifestyle, driving an old car and dressing in worn-out clothes, even to meet the country's President.

In the twenty-first century, the generation of Antonio's father managed Votorantim. In 2007, the family created Votorantim's 12-member Family Council to document the family business history and support the young generation of 75 cousins. As one of the 75, Antonio understood the message: "Craft your own path, be the best at it, and if one day the family group needs you, you'll receive an invitation." The family would not grant privileges besides a Votorantim internship during or immediately following college. Instead, in preparation for independent careers, the Family Council sponsored talent coaches for all the cousins, starting in high school, as well as workshops. "Antonio got the most out of those," commented Celia Picon, former managing director of the Family Council. "He'd always jump to the front stage at the end of a presentation, asking for the speaker's business card and a follow-up chat if the subject related to entrepreneurship." One of those people was Marilia Rocca, co-founder of Endeavor Brazil, a nonprofit supporting innovative entrepreneurs, where Antonio later interned. Another was Rodrigo Baggio, founder of CDI-Lan, a digital inclusion company in which Vox later invested.

Antonio's sense of purpose to enact societal transformation through social entrepreneurship became clear to him at age 15 in a spiritual moment at a religious retreat. He subsequently tried to learn as much as he could about pathways to address inequalities. While assessing options for college in 2002, Antonio volunteered for Gente Nueva, a foundation supporting at-risk youth in São Paulo run by José Ignacio Ávalos, who founded the Mexican microfinance bank Compartamos in 1990. "Everybody at Gente Nueva was a volunteer and had other jobs or studies to do," Antonio recalled. "So how do you get them to work? You inspire them, share a dream, make them think about the legacy."

In 2004, Antonio started his undergraduate studies in public administration at Fundação Getulio Vargas in São Paulo. "Working with nonprofits at the Junior Enterprise [a student-led pro-bono consulting network], I realized that a lot of nonprofit models had shortcomings, especially concerning the projects' sustainability and scalability. These are qualities generally achieved with profitability and the ability to bring the best people on board because you're paying them well. At my internship at Endeavor, I tried to understand how to overcome these challenges."

Antonio also avidly read about social businesses. After coming across *The Fortune at the Bottom of the Pyramid*[9] in college, he wanted to see the socially-driven companies described in its pages. He and four friends raised money from personal networks, including one of Votorantim's competitors, to shoot a documentary about the rise of the new social business model in India, believing that it could inspire Brazil. They recorded interviews with leaders from ten social businesses, including Nobel Prize Winner Muhammad Yunus, who founded the micro-lender Grameen Bank, and Dr. S. Aravind of Aravind Eye Care, a for-profit Indian hospital. These conversations culminated in the documentary *Entre Mundos*.[c]

Around the same time, upon returning from an exchange program at Babson College in the US in 2007, Antonio gathered seven cousins for a new project to redirect resources from the Family Council to invest in socially-minded startups. According to Antonio, the success of the pitch for this Family Fund stemmed from "framing it as a hands-on development program for the next generation." Starting in 2008, in consultation with lawyers and a private equity executive from Votorantim, the Family Fund disbursed two rounds of R$200,000[d]-investments structured as quasi-equity, based on the criteria of innovation, social impact, profitability, and commercial feasibility. Each portfolio company had to accept that a family member would become part of its board.

By the end of the 4-year deal term, one company lost money, returning only 23% of the fund's investment, while the other three firms returned the invested capital plus interest to the fund, for an overall internal rate of return (IRR) of 8%. Antonio reflected:

> At some point we should have hired a professional executive to run this. But then we would need to have a larger budget. Also, none of our investees achieved high levels of growth. Our initial projections were too optimistic. One thing that all entrepreneurs have in common is that they are always projecting amazing growth. Another key learning is that the profile of entrepreneurs should have been more business-oriented to assure scale.

Antonio was ready to pursue impact investing as a career, but heeded the advice of Celia from the Family Council: "Don't think of pursuing a career here with the Family Fund because it's a new project. It's a breakthrough for the family. It's too much for you to ask to be paid to do that." Instead, other cousins took over the Family Fund until its closure in 2013, and Antonio sketched another project. He explained, "My undergraduate thesis was a business plan for a social impact fund. I wanted to be a bridge between sources of capital and social enterprises, facilitating the influx of money to fund the types of businesses I saw in India. I set a goal to impact at least one million people before I turned 30."

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[c] The documentary trailer is available at: http://www.entremundos.tv, accessed January 2017.

[d] In January 2008, US$1.00 = R$1.77.

Launching Vox

When Antonio graduated from university at the end of 2008, impact investing was hardly a sector in Brazil. Oikocredit, a microfinance subsidiary of a Dutch social investor, made the first impact investments in the country in 2003.[10] Around the same time, the International Finance Corporation also launched the Inclusive Business Models Group, which started to invest in social businesses in Brazil in 2005, and the Inter-American Development Bank launched the Opportunities for the Majority program two years later, to finance businesses serving the base of the economic pyramid.[11]

While searching for partners to launch an impact investing fund, Antonio found his complements in Kelly and Daniel. Kelly also came from a wealthy entrepreneurial family. She was a boundary-spanner, an American who worked across Latin America, West Africa, and Europe, and received a masters in entrepreneurship from HEC Paris. She founded the US-based foundation Potencia Ventures and Brazil-based nonprofit Artemisia International to support social businesses by attracting and training talent for the sector. Antonio attended events run by Artemisia to meet social entrepreneurs when sourcing deals for the Family Fund. At the same time, as some of the ventures Kelly financed with philanthropy were taking off, she was considering investing with commercial-return-seeking capital as well.

A son of a middle-class electrical engineer and bank cashier, Daniel studied business management at Fundação Getulio Vargas as an undergraduate and received an MBA from HEC Montréal. He spent more than 10 years at Johnson & Johnson, leading the base-of-the-pyramid business area for consumer goods in Brazil. However, Daniel recalled, "At some point it stopped making sense to generate millions for shareholders based abroad while ignoring the people I walked by every day, living on the streets between the office and the parking lot." He championed a direct sales model for healthcare in Rio at Johnson & Johnson, but felt that he could not reach scale in the company. At the same time, he became an angel investor in Tekoha, an enterprise selling cultural artifacts from indigenous communities. There he realized the yawning gaps in financial vehicles and talent for social businesses. He consequently committed himself to impact investing, despite lacking capital. The founder of Tekoha introduced Daniel to Kelly, who brought him into conversations with Antonio.

Antonio, Kelly, and Daniel aligned quickly around their shared goals of channeling capital to social enterprises and building the ecosystem for impact investing in Brazil. Their mission became "to empower people and companies to create a more just and joyous world for everyone."[12] Together they refined the business plan that Antonio had developed for his undergraduate thesis, and in 2009 they registered both Vox Capital and the holding company Paradox Participações, held by Potencia Ventures. As CEO of Potencia, Kelly facilitated an initial US$3 million[e] of funding to support Vox through 2012, to cover its operations and investable capital up to R$1 million. "The target was to invest in 5-7 businesses during a 3-year span to test the concept and determine the optimal model for impact investing," explained Antonio.

To understand the landscape, the trio reached out to pioneers, including Vineet Rai from Aavishkaar, whom Antonio met in 2008 for *Entre Mundos*. "Just like my great grandfather, Vineet was a market creator. Vineet launched a consulting firm, an impact investing fund, and an accelerator, which set the stage for the sector in India," recalled Antonio. The partners also turned to Acumen in the US and Ignia in Mexico. "When we looked at Ignia, having met its founders in so many

[e] In January 2009, US$1.00 = R$2.33.

conferences, we realized that this was the model that we wanted to follow: a 10-year fund with measurable social impact," explained Antonio. "Ignia reflected our goals: early-stage, targeting base-of-the-pyramid markets, preference for business-to-consumer, and not compromising on financial returns."

As the founders learned about the landscape, they developed Vox's initial investment thesis. Geographically, they focused on Brazil as a large market with significant need for social investment. Vox would target the more than 120 million Brazilians living on less than US$8 per day. The partners chose the sectors of education, healthcare, and financial services due to their potential for social transformation, and the fact that many merger and acquisition deals had occurred in Brazil in these arenas in previous years, which could facilitate Vox's exits from such investments once the fund reached its defined maturity and returned the capital and financial gains to investors.

In this pilot phase, the partners had to source deals opportunistically. They reviewed Artemisia's pipeline and portfolio to identify social enterprises ready to graduate from philanthropic capital to venture capital. Their selection criteria were: the social impact of the business, the potential for scalability through innovation, the quality of the entrepreneur, and the fit with Vox's investment thesis. Between 2009 and 2012, Vox made three equity investments and provided three convertible debt loans (see **Exhibit 2** for Vox's complete fund management timeline and list of investees).

Raising Money

The year 2012 marked important transitions for Vox. As Kelly stepped back from Vox's day-to-day operations, Antonio and Daniel hired two partners to strengthen investment evaluation and portfolio management in São Paulo: Gilberto Ribeiro, 29, joining from a mining corporation, and Erik Cavalcante, 37, who had been a technology entrepreneur. Daniel explained:

> When we began Vox, it was not clear who was responsible for what. Everyone was doing everything. Over time, we made divisions: 'I am better on this, so I'll do this and you will do that.' When we brought in more partners, Antonio and I, as the main shareholders, maintained bigger weight in strategy. Today, our roles are clear. I have been the CEO since 2012 and most decision-making went through me. I am also responsible for business development. Antonio has been responsible for fundraising and investor relations, and we share external representation, depending on the network. Gilberto acts as CFO, and Erik leads the portfolio.

Vox also received its formal certification from the Brazilian Securities and Exchange Commission in 2012,[f] making it the first accredited impact investing fund in Brazil. Yet, this moment was Vox's "toughest," according to Antonio, as the seed funding from Potencia expired. Antonio recalled:

> Nobody knew about impact investing, so fundraising was really hard. Daniel and I even thought of giving up. People told us things like: 'You should find a job, because in my 20-year experience in banking, I have never had clients willing to bring the social and financial dimensions together. People want to make money.' Our portfolio companies were also not growing as we expected. Many people said 'no' before we

[f] Before receiving certification as a fund manager in 2015, Vox operated under the name of Paradox Participacoes LTDA. FIP was the investment vehicle of choice by private equity and venture capital funds in Brazil.

> started to hear 'yes.' We thought that in one year we would fundraise the whole fund. But it took us two.

Daniel added, "In Brazil, where interest rates are high and there is no familiarity with such illiquid financial products, no one would initially believe in a young group talking about the best return possible. The investors who joined us did so because of the new promise of blended return."

The first investors included well-respected figures such as Arminio Fraga, a former president of the Brazilian Central Bank and one of the largest hedge fund managers in the country. Antonio recalled trying to meet Arminio at a conference: "I started my pitch literally over the stairs to his helicopter, and by the end of the staircase he agreed on a first meeting."

Once they persuaded a small group of leaders, Vox's partners managed to raise capital from traditional sources as well. Three development finance institutions provided 44% of the committed capital: the Inter-American Development Bank International Multilateral Fund; the CAF, a Latin American development bank; and FINEP, a Brazilian innovation agency. Another 32% came from 35 Brazilian high-net-worth-individuals and families—importantly, Antonio noted, families other than his own. The foundations Instituto Alana and Potencia Ventures supplied the remaining 24%.

Vox launched Fund I with a first closing—the self-declared initial minimum threshold of capital committed by investors—at R$24 million in 2012. Taking in further capital, the team announced the final closing at R$84 million in 2014.[g] "The fund ended up oversubscribed," commented Gilberto, as the team targeted R$80 million and expected to raise R$60 million.

Finding Investees

Each of the partners were accountable for generating deal flow for Fund I. The team actively sought out leads for potential investees by attending sector events and developing relationships with incubators, accelerators, and other funds, as well as tapping personal networks. "Initially it was hard to find entrepreneurs who really understood both commercial and social ends of the equation," shared Erik. "We don't want to invest in someone who has the business skills, but is not committed to having an impact. We need to find those who will continue seeking impact once we are not there," he clarified. When turning down opportunities, Vox was careful to explain why they were not a fit with Vox's investment thesis. Antonio added:

> Initially we were looking for entrepreneurs for whom we could make a big difference with our resources. But looking at our portfolio today, the companies that are doing best are the ones that need the least from us—entrepreneurs who had already created other businesses, who had a lot of experience.

On the flip side, social entrepreneurs also struggled to find investors with hybrid mindsets. "Humanized companies attain higher profitability in the longer run, but it's difficult to find investors who get that," said Bernardo Bonjean, 39, who launched Avante in 2012 as a financial solutions provider for families and micro-entrepreneurs in Brazilian slums. "Our agents can dream of visiting 27 million micro-businesses in Brazil, a R$100-billion sector that is completely invisible to the financial system. We want to be the Airbnb of global microcredit." However, before meeting Vox in 2013, Avante had only received funding from friends and family at a R$9.7-million valuation.

[g] In January 2012, US$1.00 = R$ 1.83.

Bernardo recalled, "We reached Vox through its Speak to Us channel on its website. We were still in trial-and-error mode on how to reach the base-of-the-pyramid entrepreneur. Vox got in because of what we aimed to do and because of our culture of transparency and empathy."

By late 2015, the Vox team had sourced more than 1,400 investment opportunities, and analyzed 700 to select its twenty investments for Fund I, including six investments that the team had made already under Paradox Participações during its pilot with Potencia funding (see **Exhibit 3** for descriptions of portfolio companies, as well as their performance and investment status).[13] Of the 700 opportunities considered, a third came from active sourcing, a quarter from reactive sourcing, a quarter from the team's network, and the remainder from sectorial events, incubators and accelerators, and other funds.

Structuring Deals

Under Fund I, ten investments were in equity and ten in convertible debt. For each equity investment of on average R$5 million, Vox sought ownership stakes of 20-40%, with the goal to sell, or begin to sell, all equity holdings after six years following the initiation of the fund. The equity investments targeted start-up companies that had launched operations and could prove market acceptance of their products or services by low-income customers. These companies were in their first or second rounds of fundraising from professional investors, called Series A and B rounds respectively.

The partners managed their convertible debt investments under what they called 'Vox Labs.' Here they targeted start-up companies at the seed level, launching or about to launch a product or service. Vox's investment was generally the first external financing for these companies, at a maximum of R$1 million per deal for three years. Vox expected monthly interest payments of 1% of principal for a year after the fund's disbursement.[h] The principal and interest could then either be repaid over two years, or convert into an ownership stake at a 20% discount to the current valuation of the company's worth.

Vox sustained its own operations through fees, which it partially linked to its social impact—one of only two such funds in the world to do so as of 2014.[14] Antonio explained:

> The rate of return of Fund I was benchmarked to traditional financial structures. In Brazil, it was the consumer price index plus 6% a year. From results above that 'hurdle rate,' 80% would go to the investors and 20% to the fund manager. Of that performance fee, half depended on our rating calculated with Global Impact Investing Rating System (GIIRS), so we'd have to demonstrate measureable social impact to receive the full fee. This motivated you to achieve impact not only in intentions but also in the incentive scheme.

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[h] Fund rights during the grace period of 12 months included: right of first refusal, i.e., during the grace period, the fund must have been consulted first if the company wanted to raise a new round of investment; if the fund decided not to pursue additional investment in the company, then the company was free to negotiate with other sources of capital; conversion of the debt, i.e., if the company successfully raised a new round of investment, the fund had the right to convert the total amount of debt that it had provided the company into an equity stake in the company, with the equity stake calculated at a discount of 25% over the valuation of the company in this new round. The fund's rights after the grace period included: if the fund decided not to convert the debt into equity, the company should repay the loan within 24 months.

The non-profit B Lab conceived GIIRS in 2009 as an international standard to measure the social and environmental impact of companies and investment funds.[15] In order for Vox to receive the social impact performance fee, from 2012 onwards, the partners decided that the fund's GIIRS Impact Fund Rating score had to be above average in comparison with other funds (see **Exhibit 4** for detail on Vox's fee structure).[i] However, over time Vox redefined that threshold. Gilberto explained:

> GIIRS is not a perfect impact evaluation system. It takes into account impact criteria, skewed towards social responsibility and governance. Being above the average GIIRS-rated company in customer focus is our new benchmark [in contrast to averaging across the criteria of community, environment, workforce, governance, and clients]. Brazilian labor laws already protect the employee, which in an international rating system may be perceived as a positive effort by the entrepreneur towards social impact. But in reality it's just compliance to the country's regulations. This also raises the question: Is any fund that applies the GIIRS metrics an impact investing fund? No.

To protect investors, each sales and purchase agreement also included provisions on liquidity—ensuring preference to Vox in liquidation and new share issuance—and governance—ensuring veto power or majority voting on key matters. Daniel emphasized, "We wanted to have influence, so the entrepreneur needed to be willing to have us on the board."

Other key clauses obligated management to disclose financials and provide GIIRS assessment details to Vox, in addition to a key-person lock-up (attaching financial incentives to the requirement for key staff to stay with the company), non-compete clauses (preventing senior staff from leaving to work in similar businesses), and intellectual property protection (assuring ownership by the investee firm, not an individual). Finally, the agreements stipulated terms for due diligence, compliance, and eventual indemnification or conflict arbitrage (see **Exhibit 5** for legal agreement detail).

Before submitting a proposal to the Investment Committee, which had final say, the leading partner for the particular investment that fit Vox's thesis would list possible exit strategies. Erik explained:

> We have a deadline to exit the whole portfolio. Thus it is part of the strategy that after 6 years all our assets will be on sale. By the fourth year we start working on potential buyers and refining our pitch to be ready. We strive to understand what is the best time for the company and for its valuation to do so. For example, we have a strategic buyer bidding to get one of our companies now, and we are rejecting the offer letter because it's too low. So we are putting together a process to enhance valuation in 2 years to go back to the same buyer. We have no control of the company once we exit, but we assure that the buyer has an impact mindset to resume our influence, and we have no rush.

The Investment Committee included three men and two women with equal votes for approving the projects for financial support—one representative each from Potencia Ventures, Instituto Alana,

[i] At the level of funds, GIIRS considered the fund's investment criteria, the portfolio management and investment thesis, and the weighted average of the portfolio company's evaluations. For portfolio companies, GIIRS considered operations ratings and impact business model ratings, according to community, environment, workforce, governance, and clients.

FINEP, and Vox, in addition to an independent member.[j] Four criteria anchored the committee's deliberations: the probability of market consolidation, number of potential strategic buyers, maturity of the business model, and business acumen and network of the entrepreneur.

In the case of the microfinance provider Avante, the dating and due diligence process took almost a year, with Vox investing R$4 million[k] in 2014 for 22% of Avante's shares. "It was easy to get to the valuation," shared the founder Bernardo. "We thought R$22 million, they thought 17. We met at R$17 million but with a prize/earnout if we got to 22 till the second round. It was fast and amicable. One year later Vox joined the second round." Avante closed the new round of R$6.5 million from Leste (a Brazilian boutique investment firm), Raphael Klein (former CEO of a large Brazilian retail chain targeting the base of the pyramid), and Vox (at R$2 million) in a R$46-million valuation, which was a 171%-increase over the initial valuation.

Building Investee Capabilities

In 2015, three years after its launch, Fund I completed its investment portfolio—having engaged with twenty investee social enterprises and earmarked remaining capital in the fund for follow-on investment rounds for the two most promising firms. Yet, Vox's value proposition extended beyond financial mediation to building organizational capabilities in close collaboration with the entrepreneurs. Vox not only reviewed financial projections and budgets together with managers of its portfolio companies, but also helped them reevaluate their business strategies; improve internal governance; access lawyers, headhunters, and accountants at affordable prices; establish and strengthen relationships with incubators and accelerators; and attract other venture capital funds and investors for co-investment. Utilizing its portfolio company Plano CDE, a market research firm focused on the base of the pyramid, Vox also helped some of its other investees with analysis about consumer profiles in specific geographies and industry segments.

"Networking is probably the area in which Vox provided the most value-addition to the companies. Governance is the second one," Antonio recalled. For Avante, the founder Bernardo confirmed:

> Vox helped significantly at every board meeting. We try to implement in these meetings a dynamic that resembles the case study method. We always propose 3-5 topics, giving board members enough information to feed the debate. The topics can either be something that needs to be improved or a decision to be made. Vox has always brought useful arguments to these debates. As the only impact investing fund in our board, they have also been the guardians of impact. For instance, if we had an increase in default rates, one easy solution would be to increase our interest rates to guarantee returns. Vox always opposed that, and proposed other solutions to protect our clients.

Bernardo also acknowledged Vox's contributions in bringing global references. "Once we caught an employee making fraudulent contracts to achieve his goal of 27 closings, instead of the 24 he had signed. His family was in need. So we proposed to no longer have sales targets. Some board

[j] In parallel to the Investment Committee, Vox also created an advisory board. However, upon facing scheduling lags, the team decided to seek limited partners' advice individually such as that of Fabio Barbosa[j], a pioneer in corporate social responsibility.

[k] In October 2014, US$1.00 = R$2.48.

members thought I was crazy until Vox brought the example of a Dutch company that had eliminated sales targets with success," Bernardo added.

For Samara Werner, co-founder and executive director of Tamboro, Vox was key to counteract pressures from traditional private equity investors. Tamboro's main product was a game-based adaptive learning platform for public schools. However, Samara explained:

> In governmental institutions many think that technology solutions for education can be found online for free. So our non-impact partner suggested we could develop a system to prepare people applying for public service positions. There is a big industry around these exams in Brazil. But the clients would be middle class and the transformative potential of these exams for society is extremely limited. Vox was radically opposed.

While a number of investors liked Vox's deep level of engagement with its portfolio companies, some current and potential investors viewed Vox's close relationships with its investees wearily. Antonio recalled, "One of our investors said that Vox should be more 'cynical' when negotiating deal terms with potential investees, as the deal structure should provide more protection for investors." This limited partner admitted that the Vox team received positive feedback from entrepreneurs. "However, sometimes Vox gets too close to the founders, becoming too subjective," he warned.

Tracking Performance

The Vox team developed processes for regular oversight over its own management and strategy and investees' finances, risks, impact, and operations (see **Exhibit 6** for monitoring detail). In terms of financial performance, in 2015, the team estimated the annual financial return that it expected to give back to its investors after the fund's six-year lifetime, called the IRR, at 3.9% per year, and the total financial return that it expected to return to its investors, called the expected total net IRR, at 15.7% after costs and taxes. These estimates were based on portfolio projections that considered three forward scenarios: pessimistic (IRR -2.5%), base (IRR 15.7%), and optimistic (IRR 24.5%). In mid-2016, the team updated its projections and estimated a total net IRR of 12.4%. "It's a long-term investment that fluctuates with exits, write-offs, and we only track expected returns once a year," mentioned Gilberto. At that time, Fund I had written-off one investment, Balcão de Empregos, a job-search website.

Tracking social performance at Vox was more complicated. Through its Fund I investments, Vox aimed to impact one million people. By 2015, portfolio companies estimated that they had created 200 new direct jobs and served 150,000 people daily.[16] However, Daniel remarked:

> We started Vox to generate social transformation in our country, so if we cannot do that maybe we should be doing something else. As Vox passes its survival mode it is becoming clearer that it is not yet really changing the world, particularly considering that of any 10 businesses we invest in, only 2 or 3, maybe 4, are going to succeed. It's true that these businesses are enhancing the lives of people in specific aspects. One of our companies created a system that improves patient triage in emergency rooms, reducing the waiting time in the hospital. However, none of our firms are fundamentally changing lives.

From the outset, all portfolio companies undertook annual GIIRS assessments. Samara, co-founder and executive director of Tamboro, commented:

> Having to go through the GIIRS processes was a bit difficult, because we had to allocate time and resources to fill in a lot of reports. But at the end, completing all the questionnaires helped us rethink our day-to-day work. Being a Vox investee today helps legitimize our social business precisely because people and institutions know that we have passed these rigorous processes.

Starting in 2016, Vox also began to apply the theory of change methodology, commonly used by nonprofits. In the process, portfolio companies mapped context-specific inputs, outputs, outcomes, and impact to articulate how and why they expected social change to transpire (see **Exhibit 7** for framework detail and example for Avante). Vox then worked with the firms to create dashboards with operational indicators to track monthly.

The Vox team revisited all investees' theories of change periodically. The challenge was to find a path that attained higher levels of both financial and social performance. Capturing causality also remained elusive. Gilberto noted, "If you give millions of computers to poor children, some of them may develop eye problems for spending long hours looking at the screen. You planned for positive, but there could be negatives." In 2016, Vox began working with the Inter-American Development Bank's Multilateral Investment Fund, one of its limited partners on Fund I, to develop a new methodology to better capture Vox's social impact. "We are ahead of the game and have matured in developing metrics on impact. However, there is a long way to go still," shared an employee.

Besides having one partner as a board member in each investee firm, tracking closely companies' financial and social performance, Vox hired a full-time impact officer in 2016. Vox sought consulting or equities research experience and used the case method to screen potential hires. Through the new role, the partners hoped to improve Vox's social indicators to better understand how to transform lives. From 200 applications, the Vox team hired Jéssica Silva Rios, 28, a former manager at PricewaterhouseCoopers Brazil and MBA graduate from Insper. Jéssica commented, "It was a hard start as information on how to measure impact is scarce."

Walking the Talk

As Vox grew, Daniel and Antonio questioned regularly whether Vox was role-modeling the firm's aspirations in its own practices. The company became certified as a B Corp in 2015.[1] Julia Profeta, 30, who joined Vox in 2015 to support business development and deal analysis, explained, "B Corp is a very important first move but a long way to go to get to what we call impact. Complying with GIIRS, we are a socially and environmentally responsible company, not a true impact company. How well are we serving customers and changing lives is more than being responsible." Daniel added, "The endgame of impact investing is creating a more just and equal world. And when you are not doing this in-house, how can you do this for the outside world? There is a consistency check that has to happen internally."

Daniel accordingly instated "walk-the-talk" meetings in 2016. He reserved a weekly timeslot where any employee could bring the team together if the individual sensed Vox's practices were not aligned with its mission and values. Employees called six such conversations that year. Daniel explained:

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[1] B Corp was a certification for companies that achieved a score above 80 points in the GIIRS assessment. It served as a seal of recognition for meeting rigorous standards of social and environmental performance, accountability, and transparency.

> Three potential outcomes exist for these meetings: to stop doing something; to try changing it; or to accept that we need to live with the issue to ensure our survival right now. The first topic was investors: Whom do we take money from? First I thought: It doesn't matter as long as they don't have a say in what we do. But then someone asked: Would you take a drug lord as an investor? Of course not. So there is a line. But where do we draw it? Do you take money from companies involved in corruption scandals in Brazil? Or from sons and daughters of top executives in these companies? Another question was: Do we want an entrepreneur who has an important impact even though she does not care about it?

The team also came to walk-the-talk meetings with specific situations involving Vox investees. "I remember the case of an entrepreneur who was consistently not providing complete information in board meetings. Then what do you do? The team decided to talk to him openly and try to make him change his attitude," Antonio recalled.

The meetings succeeded in surfacing tensions, but establishing a sense of ownership and equal voice among staff was not automatic. Daniel noted:

> We are conditioned to work with clear hierarchy in a command and control model. So it is not easy for people who have power to open the floor. But also people who did not have an opinion before should prepare themselves and accept responsibility. It is not straightforward that everyone wants that responsibility.

To empower staff, Vox revised its shareholder agreement to enable high-performing new employees to join as partners after a year. In 2016, Julia became the first staff member to take advantage of this arrangement (see **Exhibit 8** for Vox's organizational chart). Vox also put limitations on executive salaries and bonuses. No executive salary could be more than 10 times that of an assistant, and no executive bonus could be a multiple larger than that of an assistant. "It is like little by little trying to recreate the world we'd want to see outside," concluded Daniel.

Advancing the Field

A study of eight Brazilian impact investment funds reported that, collectively, they managed US$177 million as of May 2014, and planned to raise an additional US$150 million in 2014 and 2015,[17] compared to a global market volume of US$60 billion.[18] Yet, the sector might be trying to run before it could walk. Daniel elaborated:

> I was at the Global Impact Investing Network forum last week in Amsterdam. You have people in the same room speaking different languages and wanting different things. I saw this large US-based mutual fund investing in one of Brazil's largest education providers. The education quality is really low and the provider only cares about profits. But the fund is representing this as a star in its impact investing portfolio. It would not stand one investigative journalist. It would be debunked right away. This is a symptom of the impact investing crowd willing to go mainstream before we sort out what our practice should be.

Antonio added:

> Goldman Sachs is rebranding certain investments as impact investing, Morgan Stanley wants to go from US$2 billion to US$10 billion in impact investing, etc. But I don't know how publicly traded big banks that have expectations from investors of

> short-term financial results will do it. People may conclude that impact investing does not work because it does not have the proper financial returns, or worse, because it does not have the proper social impact, and it is just a scheme to 'social wash' an investment.

From the outset, Antonio and Daniel saw Vox's role in building the ecosystem for impact investing as critical. Daniel explained, "How many funds would we have to launch to touch the millions of lives that are under poverty today? It is as important that we advocate for other investors to do the same in Brazil and worldwide, so we can collectively make a real impact."

In this spirit, Antonio joined the board of the Global Social Impact Investing Steering Group,[19] a task force created by the G8 to catalyze a global impact investment market. He was also a member of the Latin American Council of the World Economic Forum. Daniel helped launch the Brazilian chapter of the Aspen Network of Development Entrepreneurs in 2010, as well as the Brazilian Social Finance Task Force and the Working Group on Impact Investing at the Brazilian Venture Capital and Private Equity Association. Vox staff also wrote about impact investing for publications like *Huffington Post* and helped organize the Social Finance and Businesses with Impact Forum in Brazil in 2014 and 2016.[20]

In its most recent attempt to grow the sector, Vox launched a free online course in 2016. Julia explained, "We are only Vox. We cannot embrace the whole country. We have to sell the concept of impact and make others replicate the word. That's why we came up with the hour-long introduction course in Portuguese for professionals in the social and financial industries. It describes the impact investing sector, interesting cases, and how to deal with client impact questions."

At the same time, Vox received national and international recognition. For four consecutive years, 2012-2016, the ranking list Impact Assets 50 selected Vox as one of the 50 most important impact investing firms in the world. The Inter-American Development Bank also named Vox "the best socially responsible investment firm in Latin America" in 2014. "Being pioneers we have a lot of responsibility. We have to be cautious and transparent. It is not that if we fail, the sector or the idea is not going to blossom, but this may take some time," Daniel warned.

Looking Ahead

Fund I would keep running until 2022, when the equity and convertible loans in the portfolio would all be sold off and the returns disseminated to the investors and Vox Capital. Fundraising for Fund II started in 2016 and would continue through mid-2017, with the Brazilian Development Bank BNDES as the anchor investor. "Today we don't have to scout opportunities as we did in the early days because business plans keep on coming to us non-stop," shared a Vox employee. Julia commented:

> We have more structured touchpoints with investors now. Every 3 months we hold an event when, for instance, we dig into a sector we invest in. We had one entrepreneur bring his healthcare solution so investors could see it. Venture capital and impact investing are new in the country, so we help limited partners learn with us instead of just telling them.

Fund II aimed to raise R$120 million and deploy R$3-15 million,[m] at an average of R$5 million, in its first rounds of equity investments in 10-12 companies with revenues up to R$25 million. Vox expected ownership stakes in investee companies of 15-40%. The team planned to charge investors an annual management fee of 2.5% per year, calculated over both the remaining committed capital for the fund and over the amount invested by the fund during the investment period, minus write-offs and exits, corrected by inflation.[n] There would also be a 1% structuring fee on the first year of operation.

Vox intended to reserve 30% of the total investable fund assets for follow-on investment rounds in portfolio companies from Fund I that showed good performance and growth potential. The team also debated dedicating a pool of 2-3% of Fund II for seed ventures using convertible debt investments similar to Fund I, in partnership with an outside accelerator for mentorship. However, the team observed mixed results from ventures invested by Vox Labs in Fund I and faced reluctance from the Brazilian Development Bank.

The team also intended to utilize the theory of change methodology in the due diligence applied for Fund II, and to focus more on entrepreneurs that had not only a viable product or service, as had been the focus of Fund I, but also the proven expertise to scale their business. Fund II would continue to focus on education, financial services, and healthcare, with the possible addition of the food supply chain and energy. Antonio explained, "We are now asking: What kind of new disruptive technologies are emerging right now that could be a game changer in empowering the largest part of the population?"

Vox was continually questioning not only its practices at all stages of investment, but also the fund structure. What funding sources should Vox privilege for Fund II? Should the team change the investee selection process? Was it time for Vox to internationalize its portfolio? What interests did Vox's deal structures protect? Was Vox role-modeling the kind of change it wanted to see in the world? Most importantly, was the company actually generating the impact that it aspired to catalyze? If not, what changes should it prioritize?

Daniel and Antonio also often wondered about Vox's role in the evolving sector. "If we deliver above market-rate returns, are we helping reduce inequality, or are we contributing to inequality? How do you really look at the whole system?" Daniel reflected. Instead of mainstreaming, perhaps the movement needed disruption. He continued:

> As a fund manager, I sometimes feel powerless to create an off-the-beaten-track financial instrument. In my experience, people are willing to accept one odd thing. If I come with impact and a new structure, my feeling is that I would have zero chance to fundraise. So for now I bring impact to a safe financial structure. We are working hard to get a good track record on Funds I and II so that we can innovate more on Fund III.

As the partners prepared to finalize Fund II's investment thesis, all these issues were in the forefront of their minds.

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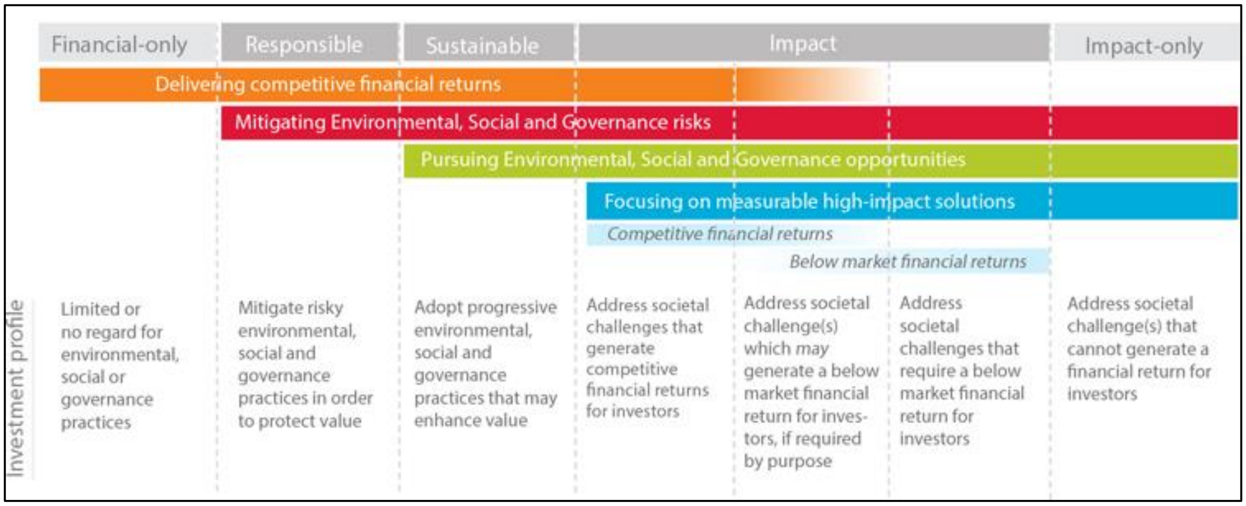
[m] In November 2016, US$1.00 = R$3.41.

[n] If Fund II co-invested with another vehicle managed by Vox Capital, the management fee would suffer a discount. If the duration of the fund were extended, the management fee would reduce to 1.75% per year.

Exhibit 1 Background on Investment Types

Investments combining social and financial returns can fall along the following spectrum, from financial- to impact-only.



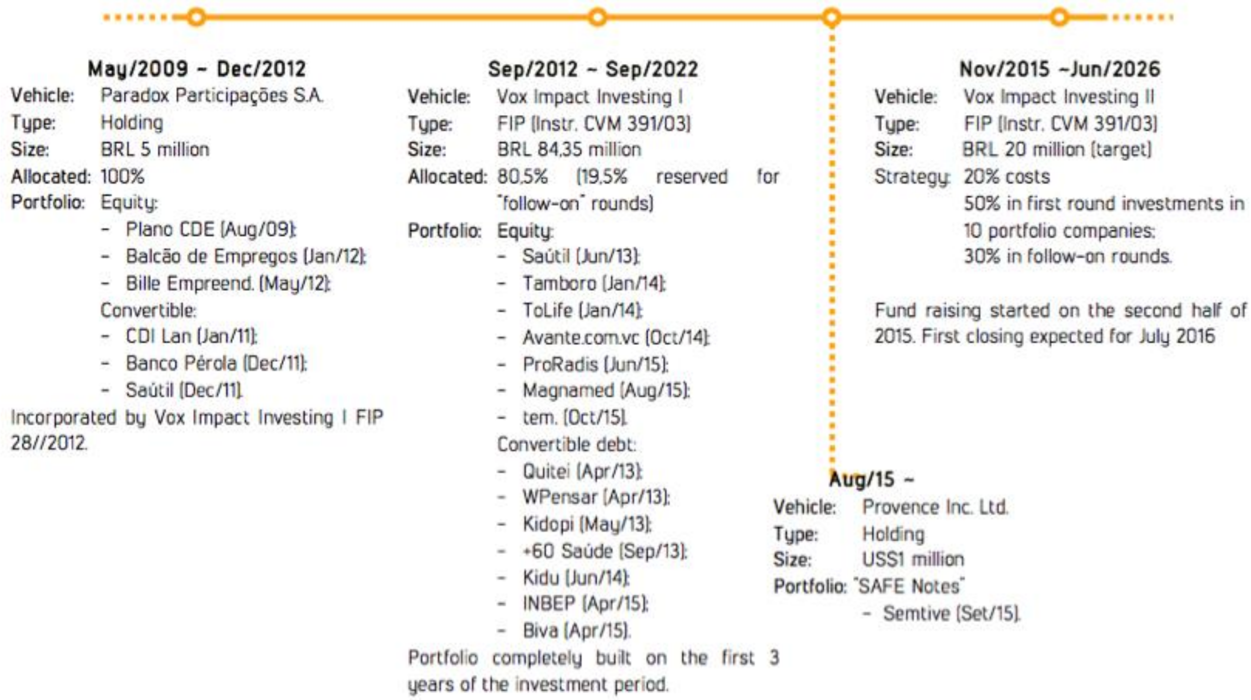
Source: Clara Barby and Emilie Goodall, "Building Impact-Drive Investment Portfolios," in *From Ideas to Practice, Pilots to Strategy II* (World Economic Forum, 2014).

An investor might use the following possible simplified mechanisms.

Investment Mechanism	Financial Return Calculation	Financial Return Dependent on Company Revenue	Extent Investor Participates in Creating Equity Value	Extent of Investor Priority in Liquidation	Extent of Risk to Investor	Investor Orientation
Equity	Value increase of ownership stake at exit, i.e., upon sale of the stake)	Yes	High	Low	High	Believes that future buyers exist and company value is definable
Quasi-equity/ mezzanine	Debt/equity hybrid, e.g., loan with flexible interest rate tied to investee revenue, which can convert to equity	Optional	Optional	Medium	Medium	Wants to align with business interests to grow
Loan/debt	Fixed interest rate plus repayment of principal amount	No	None	High	Low	Seeks return regularity
Grants/ donations	None	NA	NA	NA	NA	Supports social impact

Source: Casewriters.

Exhibit 2 Vox Capital's Fund Management Timeline, 2009-2026



Source: Company documents.

Note: FIP (Fundo de Investimento de Participacoes, or Investment Fund by Partnership) is the investment vehicle of choice by private equity and venture capital funds in Brazil.

Exhibit 3 Fund I Portfolio Company Descriptions, Performance, and Investment Status, 2016

	Company Name	Core Activity	Date Invested	Amount Invested (BRL '000)	IRR	GIIRS Impact Models Rating	GIIRS Operations Rating	GIIRS Overall B Score	Investment Status
Equity	**Plano CDE**	Understand the base of the pyramid	Aug-09	3,284	0.0%	Gold	***	99	Active
	Balcao de Empregos	Provide information on job opportunities	Jan-12	2,569	-100.0%	Platinum	***	122	Write-off
	Bille	Build and facilitate home financing	May-12	368	38.1%	Platinum	Rated	88	Writing off
	Sautil	Provide information to access public healthcare	Jun-13	3,555	0.0%	Gold	Rated	73	Active
	Tamboro	Develop adaptive game-based learning platforms	Jan-14	4,500	-23.0%	Platinum	***	113	Active
	ToLife	Develop technology to reduce hospital waiting	Jan-14	10,000	-7.4%	Platinum	Rated	101	Active
	Avante	Provide credit for families and microentrepreneurs	Oct-14	6,000	56.2%	Platinum	****	151	Active
	ProRadis	Provide software for scheduling medical exams	Jun-15	3,000	72.6%	Silver	Rated	69	Active
	Magnamed	Produce medical devices for intensive care units	Aug-15	10,000	231.5%	Gold	Rated	90	Active
	Tem.	Facilitate payment and discounts for medical care	Oct-15	3,000	39.3%	NA	NA	NA	Active
Convertible debt	**CDI-Lan**	Operate cyber cafes to promote digital inclusion	Jan-11	150	0.0%	NA	NA	NA	Write-off
	Banco Pérola	Provide microcredit for entrepreneurs	Dec-11	100	-2.4%	NA	NA	NA	Partial loss
	Sautil	Provide information to access public healthcare	Dec-11	55	0.0%	NA	NA	NA	Converted to equity
	WPensar	Produce school management systems	Apr-13	300	11.3%	NA	NA	NA	Fully exited
	Quitei	Offer online service to renegotiate debts	Apr-13	150	3.2%	NA	NA	NA	Fully exited
	Kidopi	Develop healthcare technology	May-13	50	3.3%	NA	NA	NA	Fully exited
	+60 Saúde	Offer low-cost healthcare for senior patients	Sep-13	150	13.1%	NA	NA	NA	Fully exited
	Kidu	Provide online education platforms	Jun-14	300	0.0%	NA	NA	NA	Write-off
	Biva	Offer online microcredit to families and entrepreneurs	Apr-15	300	-84.2%	NA	NA	NA	Write-off
	Inbep	Provide online training in work safety	Apr-15	300	12.8%	NA	NA	NA	Repaying

Source: Company documents.

Note: Active means the company was still in the portfolio under Vox's management. Write-off means Vox left the investment at a loss of 100% of the invested capital. Writing off means Vox intended to leave the investment at a loss. Partial loss means Vox left the investment at some loss. Converted to equity means Vox exchanged its principal and interest for an ownership stake. In case of equity, fully exited means Vox sold its stake at a profit; in the case of convertible debt, fully exited means that the loan was either repaid in full or converted to equity. Repaying means the company was in the process of returning principal and interest to Vox.

Exhibit 4 Vox Capital's Performance Fees for Fund I

Fund managers in the private equity/debt industry are normally referred to as general partners. Their investors are limited partners. General partners usually finance their operations through a management fee and a performance fee. Both fees are charged to the limited partners. The management fee is charged every year, and is usually at or around 2% of the fund's total invested or committed capital.

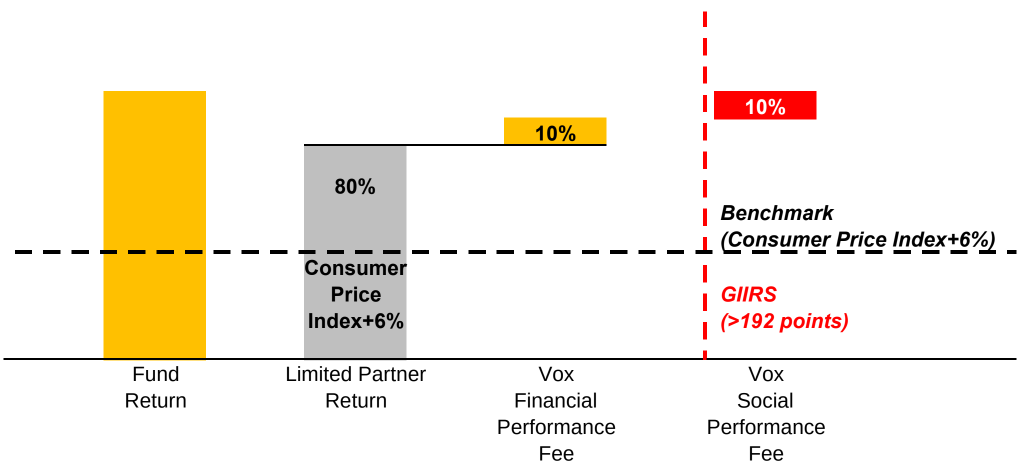
The performance fee is usually 20% of the total sum of the total value increase of the fund portfolio over its lifetime. The performance fee is calculated net of fees, and does not apply to the entire financial return of the fund. Instead, the performance fee applies to the value increase above and beyond a pre-defined 'hurdle-rate,' which is a pre-defined minimum financial return.

In the case of Fund I, Vox defined the hurdle rate, or benchmark, as the annual percentage increase of the consumer price index plus an annual return of 6%. Vox would receive 20% of the financial returns achieved above this benchmark. This typical fee structure is also called the "2 and 20" model, a standard term in the fund management industry.

Similar to the standard model, Vox, as the general partner, would calculate and distribute the performance fee at the end of the life of the fund, after all investee holdings were sold off and the capital was to be redistributed to fund investors, i.e., the limited partners.

The novelty of the Vox model lied in the performance fee being split into two halves. One half was based only on financial performance. The other half was based on financial performance as well, but was also dependent on the achievement of a minimum social performance.

Hence, Vox's financial performance fee would be 10% of the total sum of the financial return achieved by the fund above the minimum agreed benchmark. The social performance fee would amount to the same sum as the financial performance fee, but only be paid to Vox if the fund had exceeded the minimum financial return, *and* if it had achieved the agreed minimum GIIRS rating of 192 points. The figure below illustrates the model.



Source: Company documents.

Exhibit 5 Key Aspects of Vox Capital's Legal Agreements with Investees, 2016

Governance:

- ***Shareholders assembly***. The fund would maintain its influence through veto powers or qualified majority voting on relevant themes such as (i) mergers, acquisition, and other deals involving shares of the company, (ii) material changes to the bylaws, (iii) issuance of new shares, (iv) dividends policy, (v) transactions involving intellectual property, (vi) changes to the board of directors and (vi) transactions among related parties.
- ***Board of directors***. The fund would always have at least one seat at the company's board of directors, appointed by Vox. At the board, the fund would maintain its influence through veto powers or qualified majority on relevant themes such as (i) capital structure and corporate leverage, (ii) approval of the company's business plan and budget, (iii) stock option plans, (iv) relevant off-budget expenses and (v) key personnel hiring and compensation.

Liquidity:

- ***Liquidation preference***. Shares bought by the fund were usually preferred shares with special voting rights and liquidation preference over ordinary shareholders up to, at least, the amount invested by the fund.
- ***Preference in new stock***. The fund had preference to subscribe in new stock issued by the company.
- ***Tag along***. The fund structure protected minority shareholders.
- ***Drag along***. Individual right of the fund as a shareholder to enforce other shareholders to sell out company stock if it received a proposal conditioned to that (this provision, however, was seldom accepted by entrepreneurs and other shareholders).
- ***Put option***. Legal instrument allowing the fund to sell all of its shares back to the company for R$1,000 if the fund wanted to do so (in the case of write-offs, for example).

Shareholder protection and conflict resolution:

- ***Due diligence***. Prior to closing the deal, the fund conducted a due diligence in accounting, tax, labor, and legal risks performed by independent lawyers and auditors.
- ***Representations, warranties, and indemnification***. Clauses with representations and warranties made by the company and the founders on relevant compliance matters and on the veracity of the information provided. For every breach of reps and warrants, the fund shall be indemnified.
- ***Arbitrage***. All conflict resolution regarding the investment terms and the company management were dealt through arbitration chambers. Each of these terms were negotiated individually on a deal basis, along with the terms regarding shares pricing (valuation) and the fund's investment disbursement schedule.

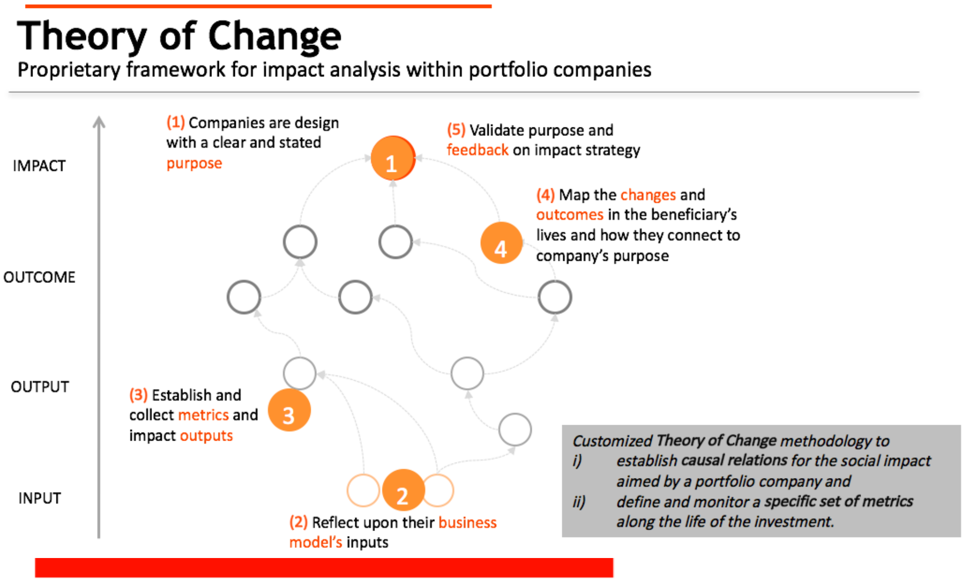
Source: Company documents.

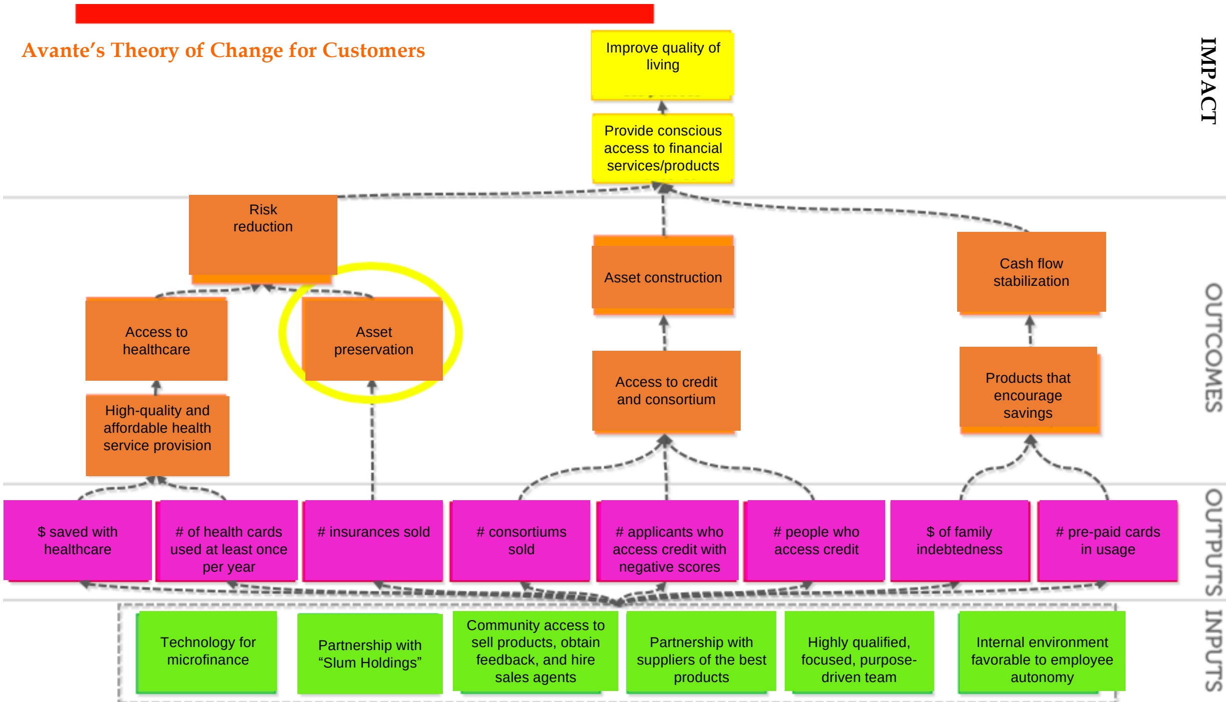
Exhibit 6 Frequency of Vox Capital's Monitoring of Investees, 2016

Monitoring Type	Pre-Investment	Monthly	Annually
Finance	Definition of business plan and 5-year budget, including core financial metrics for businesses.	Gathering and analysis of company balance sheets. Issuing managerial reports (financial reporting pack). Budget review. In-depth analysis of revenues; earnings before interest, taxes, depreciation, and amortization; profit and loss; burn-rate; indebtedness; cash flow.	Third-party auditing. Analysis and approval of company's budget. 5-year plan review.
Risk	Third-party legal and accounting due-diligence, ending in dashboard with a summary of risks for monitoring during board meetings.	Gathering and analysis of certificates, e.g., Brazilian Internal Revenue Service, taxes, workforce expenses. Review of burn-rate, available cash, indebtedness, etc.	Independent assessment of internal controls, highlighting main risks related to managerial procedures.
Impact	Development of company's theory of change. Definition of key impact metrics for monitoring.	Gathering and analysis of output indicators.	GIIRS assessment. Outcomes evaluation (when possible).
Operations	Investment memorandum with market analysis and 5-year business plan, with key operational indicators.	Gathering and analysis of operational indicators. Board meetings.	Strategic planning and budget update, led by company's board.

Source: Company documents.

Exhibit 7 Vox Capital's Theory of Change Framework and Avante Example, 2016





Source: Company documents.

Exhibit 8 Vox Capital's Organizational Structure, 2016

Source: Company documents.

Endnotes

[1] For example, see: Abhilash Mudaliar, Aliana Pineiro, and Rachel Bass, "Impact Investing Trends: Evidence of a Growing Industry," Global Impact Investing Network, December 2016.

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