



A recipe book for **social finance**

Second edition

A practical guide on designing and
implementing initiatives to develop
social finance instruments and markets

Manuscript completed in October 2018

This practical guide has been prepared as part of the contract commissioned by the European Commission to a consortium of experts led by NGen Impact GmbH, to review of a series of European projects on boosting the demand and supply side of the finance market for social enterprises. The current edition updates a previous version, submitted by RAND Europe and Ecorys in 2016. Eva Varga and Malcolm Hayday are the authors of both editions.

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A practical guide on designing and implementing initiatives to develop social finance instruments and markets

Eva Varga and Malcolm Hayday



Foreword

The European Commission wants to build a strong and resilient social market economy, one that works for people and that will be the basis for a climate-neutral and healthy planet.

Social enterprises, which have social and environmental objectives at the core of their business models, play a role in making this a reality. They create inclusive jobs and boost citizens' participation in their local communities. They bring about innovative solutions to societal challenges. Many of them are active in creating a circular economy and clean technologies, and can thus help make a just transition towards a climate-neutral continent.

The European Commission recognises and values this contribution, and is therefore helping to create favourable conditions for social enterprises to fulfil their potential. Some of the challenges social enterprises face are related to lack of finance and lack of capacity to access finance. Therefore, part of the EU's support addresses these gaps.

The EU's Employment and Social Innovation Programme pioneered a guarantee scheme for social enterprise finance. Under the European Fund for Strategic Investments, innovative social impact instruments were launched to support, for example, investments in social incubation and acceleration. Based on this experience, the new EU multi-annual financing arrangements (2021-2027) envisage a substantial increase in support for social investment.

The Directorate-General I lead has also sought to develop and strengthen social enterprise finance markets by mobilising stakeholders across Europe. Around 40 pilot projects have been financed since 2013, some of them focusing on designing investment readiness and capacity-building programmes for social enterprises, and others working on financial instruments for social enterprises.

To disseminate the experience and lessons from these projects more widely, we commissioned this practical guide. We recognised that there were many publications about starting and growing social enterprises, but there was little coherent material available to investors and intermediaries of social enterprise finance. The first edition of this guide was published in 2016 and has now been updated to take into account new market developments and the experience of the more recent pilot projects.

I trust that this practical guide will help you to develop your appetite for translating ideas into actions for a more inclusive society, one where both people and our planet can thrive. Should you not find a recipe that works for you, I hope that you will still be inspired by the many examples presented in this guide, and I encourage you to be innovative, partner with other social enterprise finance providers and design your own recipe for social finance.



Joost KORTE

Joost Korte
Director-General for Employment, Social Affairs and Inclusion
European Commission

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Introductory note from the authors

Welcome to the second edition of this Recipe Book. We are not sure that social enterprise or social investment started with food, but history tells us that social enterprises connected with the early monasteries were rooted in food production and agriculture. More recently, we know that consumer cooperative ventures started when the Rochdale Society of Equitable Pioneers set up shop. Today, food in all its forms plays a significant role in social enterprise.

In 2015, the authors of this Recipe Book were given the opportunity to create a practical guide to designing and implementing initiatives to develop social finance instruments and markets on behalf of the European Commission, Directorate-General for Employment, Social Affairs and Inclusion. There are many guides to social enterprise available, but few that extend beyond academia for potential investors and financiers. We wondered what our guide would comprise if we thought of this task as preparing a meal ⁽¹⁾.

First, **the ingredients**: social enterprises are people-centred businesses. They start with people's needs and are ultimately successful or not according to how they work with their investors and support organisations within a system of shared values.

Next, **the timing**: some social enterprises are rapid, pop-up businesses that respond to a crisis, but many take time to develop. These are slow cookers in which the relationships take time to blend together. Investment and other forms of finance can also take a long time to grow from their organic roots; they are rarely genetically modified. But being slower to start, enterprises can also be slower to fail. The intermediaries (financial and non-financial) are onside with the enterprises they support.

Third, **the preparation**: there is no single chef, no template recipe. You can draw inspiration from investors and intermediaries who have gone before you, but also from your contemporaries who may be trying different mixes of ingredients, often referred to as hybrid finance. Your recipe will reflect your risk, impact and return appetites.

And, finally, you have **the taste** experience: does the recipe excite your taste buds? Does it achieve what you wanted it to achieve? Can it be replicated or taken to scale? Or are you happy with more modest successes? Little did we realise, when we started to search for the ingredients in 2015, how quickly things would change and how much appetite there was to be part of the mix. Ingredients were renamed and business terminology thrown around with abandon.

So we were delighted to be given the opportunity to update our Recipe Book. For those of you familiar with the first edition, you will find that we have now tried to make the book a little more enduring by moving fast-changing figures and measures to the footnotes. We have reordered the chapter on intervention strategies (Chapter 4), and in so doing hope to have clarified what is meant by investment readiness and by capacity building. Chapter 7 is a new addition, looking at how to achieve optimum meal production, or as an investor would term it, going to scale.

We have updated our examples and included new ones, reflecting the fact that over the period 2016-2018, 20 new pilot projects took part in the Employment and Social Innovation (EaSI) programme. While our ingredients may go by different names today, and the ever-changing world of technology and artificial intelligence (AI) may make different methods possible, the essential elements of people, money, needs and values remain constant.

1 Thanks also to Mayo (2018) for inspiration.

A. What is the purpose of this guide?

This guide is intended to facilitate access to social finance by encouraging investors to provide suitable supply or build capacity for sound demand. While respecting the various organisational models and social missions of social enterprises, we want to see how external social finance can help implement their enterprise models, especially as they grow, without resulting in mission drift.

Simple intuition teaches us how to invest, but we also need to learn how to take into account the special nature of social finance. Social finance is more than the financing of enterprises and initiatives with social and environmental benefits, a service that is already provided to larger social enterprises and other third sector organisations by mainstream financial institutions. Just as importantly, social finance is about the societal, cultural or environmental – as well as economic – impact of that finance and what it facilitates. We see social finance as sustainable finance, by society for society. We would like to invite investors and supporters, big or small, to engage and have a stake in the impactful social enterprises of the future.

Social finance markets have been developing dynamically in many European countries, resulting in innovation and experimentation. Ingredients from third-sector finance ⁽²⁾, as well as from classical mainstream finance and public sources, have been adapted to design financing products that seek to meet the needs of social enterprises. Some markets are very advanced; others are waiting for the birth of the first loan fund or impact-oriented investment, while a decreasing number are still waiting for the pioneers that will set them up. There have been numerous projects on the demand side as well, set up with the aim of generating a constant flow of quality social enterprises that are ready for investment. Many experiments have been documented, and some authors have shared their recommendations with the next generation. While we cannot describe all these experiments in detail here, we would like to guide current and future actors through the thinking and decision-making process to help them to take and mix the ingredients to ultimately ensure that the outcome meets the demand of their customers.

B. Who should read this guide?

We hope that this guide will be of interest to private sector organisations, partnerships and individuals who are interested in strengthening the supply or demand side of the social finance market in their locality, country or region, or at European or global levels. Experience has also taught us that this Recipe Book is of interest to public authorities, especially those that may run programmes to mitigate early-stage investor risk or subsidise capacity-building and investment-readiness programmes that might otherwise struggle for sustainability.

It is usually a good idea to cook a dish for two before inviting the entire neighbourhood for dinner. Equally, we hope newcomers will find our guidelines and case study examples useful before they choose to pilot a social finance instrument or roll out a social finance scheme that has already worked at a small scale.

2 Explanations of terms, such as 'third sector', are included in a glossary at the end of this guide.

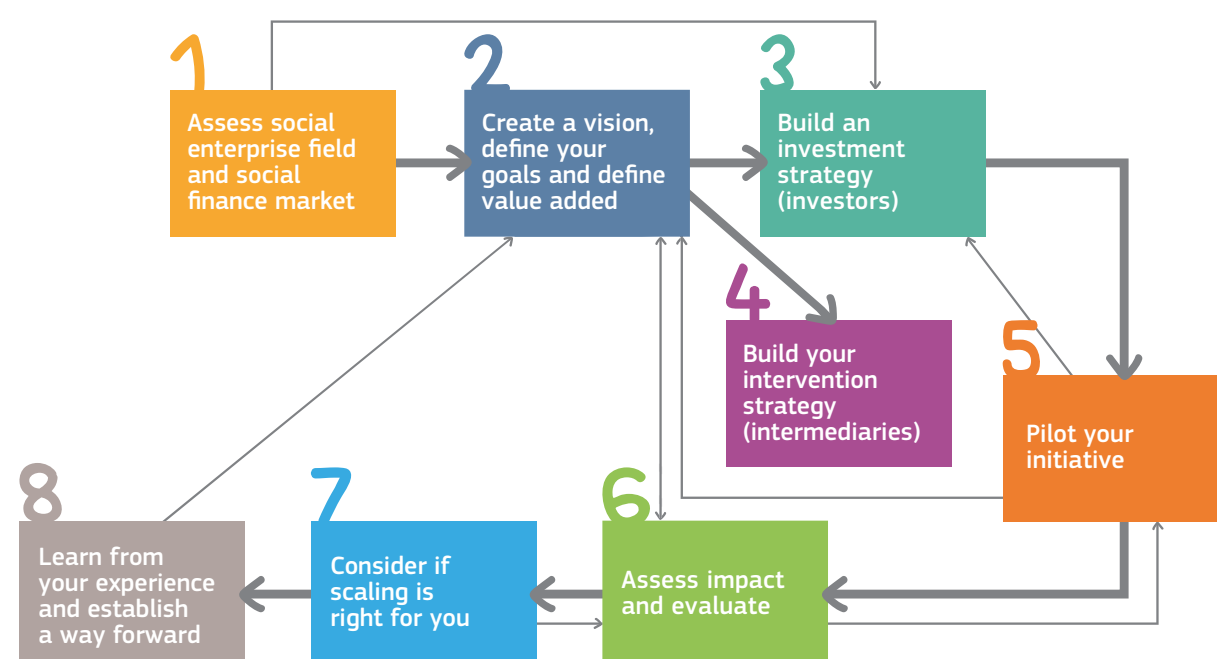
This guide is aimed at practitioners, mainly financiers, social finance intermediaries, market builders and social enterprise support organisations, but is also likely to interest social enterprises and certain individuals. It is not a policy paper. The policy and regulatory environment is considered as a given, except if it is the enabling environment and regulatory framework itself that some stakeholders are trying to develop. Policymakers and public sector stakeholders are advised to read this guide to develop their understanding of the perspectives and considerations of other actors in the social investment field. Public authorities can strengthen the ecosystem by providing enabling grants, matching other financial sources and/or providing catalytic first-loss guarantees. They can encourage social value in the supply and purchasing chains or incentivise the development of the market in other ways.

Whoever you are, we hope that, through this guide, you will begin to connect with like-minded individuals interested in building a better world through their investments and support.

C. How should this guide be used?

As shown in Figure 1, this guide is divided into eight chapters that follow the thought and decision-making process that investors or support organisations and intermediaries can pursue in designing and piloting their initiative. The thick arrows show the logical progression of steps, while the thin arrows represent feedback loops. The chapters take you through the process, pointing out key considerations and possible pitfalls, illustrated by case studies and examples where possible. The guide does not provide detailed descriptions or definitions of financial instruments or regulations but has a list of key concepts in the glossaries and annexes. The References section also includes tools and good practice that have been developed by others, plus existing literature. Examples, checklists and key questions at the end of each chapter should help you to summarise your learning and move on to the next step. However, feel free to dip in and out as you wish. You do not have to follow each chapter from beginning to end.

Figure 1. Logic of this guide



D. What's in this guide?

Reading through this guide will help you:

- learn about the issues of the availability of finance for social enterprises;
- clarify your own values and build your personal investment compass;
- determine the prudent allocation of your portfolio to direct investment or via a fund;
- decide the balance you want to achieve between social and financial return;
- learn how to assess risk and the alignment with your values of an investment opportunity;
- learn about the basic concepts of portfolio management ⁽³⁾ and the tools needed to assess your liquidity and risk profile, if you haven't already done so;
- decide how to support the actors of the social finance ecosystem as an intermediary with capacity building, or investment and/or enterprise readiness, or by understanding how to measure impact and applying those learnings.

The first chapter offers an initial assessment of the market, the needs and the available options. You will need to understand this investment landscape before moving on to the next step, creating your vision – whether as an investor or as an intermediary – and defining your goals and specific value added, as described in Chapter 2. Following this, you will need to think about whether you are a financial investor who wants to add funding to the market, thereby increasing the supply, or a support organisation or financial intermediary who wants to develop investment opportunities, thereby addressing the demand side or acting as a market builder/facilitator. Chapters 3 and 4 address these two sides of the social finance relationship by looking at how to develop the supply and demand sides with both financial and non-financial investment. In Chapter 5, you can read about key operational considerations for implementing the pilot of your initiative, while in Chapter 6 you can learn about managing outcomes and social impact. Chapter 7 discusses what happens after a successful pilot and considerations for scaling. Finally, in Chapter 8, the authors recap lessons learnt and discuss key conclusions and possible ways to move forward.

E. Sources for this guide

In compiling the guide, the authors have relied on research, reports and case studies that are available in the public domain, as well as their own experience in developing and investing in social enterprises. A major source of examples and lessons learnt are the pilot projects supported by the European Parliament Preparatory Action titled ‘Supporting the demand and supply side of the market for social enterprise finance’. This call for proposals was launched by the European Commission to address both demand- and supply-side barriers to social enterprise development and financing in the European Union (EU). Its aim was to support the development of a social finance market, enabling more social enterprises to take on repayable financing for developing and scaling up their innovative business models and disseminating good practices. A total of 21 projects were funded in 2014-2015, with a further 20 supported in 2016-2018. Collectively, they will be referred to as ‘pilot projects’ throughout this guide and are used as examples or case studies to illustrate interesting solutions, good practices or innovative approaches ⁽⁴⁾.

F. Definitions used in this guide

In the last years of the 20th century and the early days of this century, a new lexicon appeared that included such phrases as ‘asset class’, ‘social impact’, ‘scaling up’ and ‘social return on investment’. Words that were once used to describe programmes by states or agencies, such as the World Bank, to improve the condition of society, were subsequently adopted by the private sector and have since morphed into newer terms such as ‘impact investing’. As has been stated above, social finance is not merely about the financing of social, cultural or environmental initiatives per se, a significant amount of which is already carried out by mainstream financial institutions; nor is it just about money flowing in a more ‘socially impactful’ way. Social finance is about developing a new paradigm of finance where investment decisions are based on values and assessed in a holistic way, taking into account the planet and its people as well as profit.

First, the key terms that are used throughout this guide are expanded upon. Definitions and explanations of other terms can be found in the glossaries.

Social enterprise

Social enterprise means an undertaking, regardless of its legal form, which:

- i. in accordance with its Articles of Association, Statutes or any other statutory document establishing the business, has as its primary objective the achievement of measurable, positive social impacts, rather than generating profit for its owners, members and shareholders, where the undertaking:
 - provides services or goods which generate a social return and/or;
 - employs a method of production of goods or services that embodies its social objective;

- ii. uses its profits first and foremost to achieve its primary objective and has in place predefined procedures and rules for any circumstances in which profits are distributed to shareholders and owners in order to ensure that any distribution of profits does not undermine the primary objective;
- iii. is managed in an entrepreneurial, accountable and transparent way, in particular by involving workers, customers and/or stakeholders affected by its business activities ⁽⁵⁾.

Although the public understanding and legal definitions of the term ‘social enterprise’ vary across European countries ⁽⁶⁾, this guide is using the social enterprise definition given by the EaSI Regulation and which stems from the Commission 2011 Communication on a Social Business Initiative. Where legal definitions exist at national level, they are often narrower than the EaSI definition.

Social investment and social finance

Social investment:

- pursues an accountable social, cultural or environmental purpose;
- is independent of the state;
- has the mission of the investee as the principal beneficiary of any investment;
- is transparent about assessing, measuring and reporting the social impact it seeks to create;
- is structured to create financial value or organisational or community capacity over time, e.g. by helping the investee invest in growth, acquire an asset, strengthen management, generate income and/or make savings and by providing wider non-financial support;
- is inclusive;
- is at least nominally repayable ⁽⁷⁾.

The term **social finance** is often used to mean something broader: funding to achieve social as well as financial return ⁽⁸⁾. It has the same characteristics as social investment, except that the funding need not be nominally repayable. Grants, gifts or money given without condition are as important to social enterprises as equity and grants are to private and public companies. Social banks have long recognised that gift money plays a vital role in social finance. All of the pilot projects used grants themselves (see Annex 1) and succeeded in helping some of their portfolio organisations obtain grants.

4 A description of the Preparatory Action can be found in Annex 1.

5 Regulation (EU) No 1296/2013 of the European Parliament and of the Council of 11 December 2013 on a European Union Programme for Employment and Social Innovation ("EaSI") and amending Decision No 283/2010/EU establishing a European Progress Microfinance Facility for employment and social inclusion.
6 European Commission (2015a) provides further information about these different understandings in its Section 2.2.
7 Alternative Commission on Social Investment (2015).
8 Wikipedia (n.d.a).

Social investor

There is an array of different definitions of **social investor**, but essentially, a social investor invests for the primary purpose of supporting a vision of a better world or, within that, they invest in an organisation that is able to have a positive social impact by virtue of their investment. While a social investor may seek market-comparable returns where these are still beneficial to the investee, there are likely to be concessions in favour of the mission and the impact of the investment. To a social investor, some degree of financial return may be important, but is not essential and there may be a risk of losing some or all of the capital sum; the social impact is the priority. Comparing the relative value of different social impacts can be a formidable challenge. In the end, your choices as a social investor will be driven by your values and interests, rather than purely financial calculations ⁽⁹⁾.

Some social enterprises have always had loans and mortgages from commercial banks, but this doesn't make the bank a social investor. Rather, social finance seeks to influence the attitudes and, consequently, the behaviours of investors so that consideration of social impact becomes a fundamental aspect of investing. The conversation moves from personal gain to the implications for society and social wellbeing, therefore serving to create a more responsible and relational culture. Your investment choices have consequences for others as well as financial returns (or the absence thereof) for yourself.

As with other forms of investment, there is no strict rule for who can be a social investor. Social investors can be individuals, groups of people, private organisations or public bodies. It just requires the appropriate mindset.

Am I a social investor?

How do you know if you are a social investor? Try answering the questions in Exercise 1 and decide for yourself.

Exercise 1. Social investor checklist

Part 1: These questions should be answered off the top of your head and are designed to explore how attuned you are to wider social issues, rather than just the financial economy.

	My responses
What are my values?	
What are the most important social issues to me?	
What knowledge of charity/social enterprise do I have?	
Where do I want my money to work?	
Who do I currently bank with?	
What financial return do I need from my money?	

Part 2: These questions seek to add weight to some of your answers. A preponderance of answers in the right-hand column would suggest that you are a social investor already or are open to becoming one.

	My responses		
	Not at all	Somewhat	Defintiely /A lot
Am I a generous person?			
Am I philanthropic?			
Do I know any social investors? Have I talked to them about social finance or their investments?			
How aligned are my values (from Part 1) with everything I do?			
Do I care what happens to my money as long as it's there when I need it?			
Do I care about the impact my money has on others?			
Do I measure the impact my money has on others?			
If I do measure the impact, does this affect the way I use my money in the future?			
Can I achieve greater impact by investing my money than by giving it away?			
Am I willing to accept that I may not receive a financial return of the principal sum or a market based interest or dividend on the investment?			
If there is high social impact, am I willing to forgo some of the principal?			
Do I believe investing and giving are complementary?			
Is transparency important to me?			

9 At the Good Deals + Beyond Good Business conference held in London in March 2018, a concern was raised about whether investors really understand the level of impact lost by seeking an extra 1 % of financial return.

Social finance ecosystem

The **social finance ecosystem** includes providers of social finance and social enterprises, plus all stakeholders who participate in, influence or are impacted by social investment activity. When using the term **social finance/ social investment market**, this guide will be focusing on the marketplace where demand and supply meet (i.e. transactions between investors, intermediaries and social enterprises).

The ecosystem is made up of a growing number of **investors** who seek to use their capital to meet economic, social, cultural and environmental objectives. The landscape is characterised by great level of variety in terms of motivation; target markets, which reach beyond social enterprises and third sector organisations; the desired return; and investment type. Government is included as a market builder, catalyst, matched funder, policy framework developer and ‘incentiviser’ (through the tax system), but it does not meet our social investment definition.

An increasing number and range of **social finance intermediaries** (termed ‘service providers’ by the Global Impact Investing Network, GIIN) have emerged to connect investors with investees and target communities. Intermediaries bring together the resources, finance, skills, spaces, systems, market development and engagement to facilitate deals and provide services. A growing number of intermediaries are providing digital platforms to connect money with enterprises.

Social enterprises, which can have many forms and stages of development, are often unable to access finance at certain stages in their life cycle. **Third sector organisations** include two traditions: one of mutual self-interest, exemplified by cooperatives and mutuals, and another of charity, where people and organisations respond directly to social needs. Together with social enterprises, third sector organisations comprise much of what is also known as the ‘social economy’. Many of the ‘recipes’ presented in this guide are also applicable to third sector organisations.

A well-functioning market relies on appropriate **infrastructure**, such as specialist risk management skills, trade groupings and networks, education, metrics, benchmarking, trading mechanisms and routes to market, some of which have to attract subsidy because social returns do not attract capital in the same way as financial returns do.

The social finance ecosystem is like any other ecosystem. It is not static; it is dynamic and continually adapting to change. Through financial technology disruption, this pace of change is likely to accelerate as financial markets in general are experiencing. The impact of technology is addressed later in this book in chapters 7 and 8.



Chapter 1

Assess the social enterprise field and social finance market

The demand and supply sides; key elements

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Learning objectives

On completion of this chapter, you should be able to:

- understand why it is important to assess the market before setting up a new initiative;
- consider the ingredients of a social finance market: demand side, supply side and others;
- understand the key characteristics of each ingredient;
- conduct research and analysis of the market in a number of ways;

➤ ask the key questions to aid your conclusions about the market;

➤ identify barriers and opportunities for your involvement.

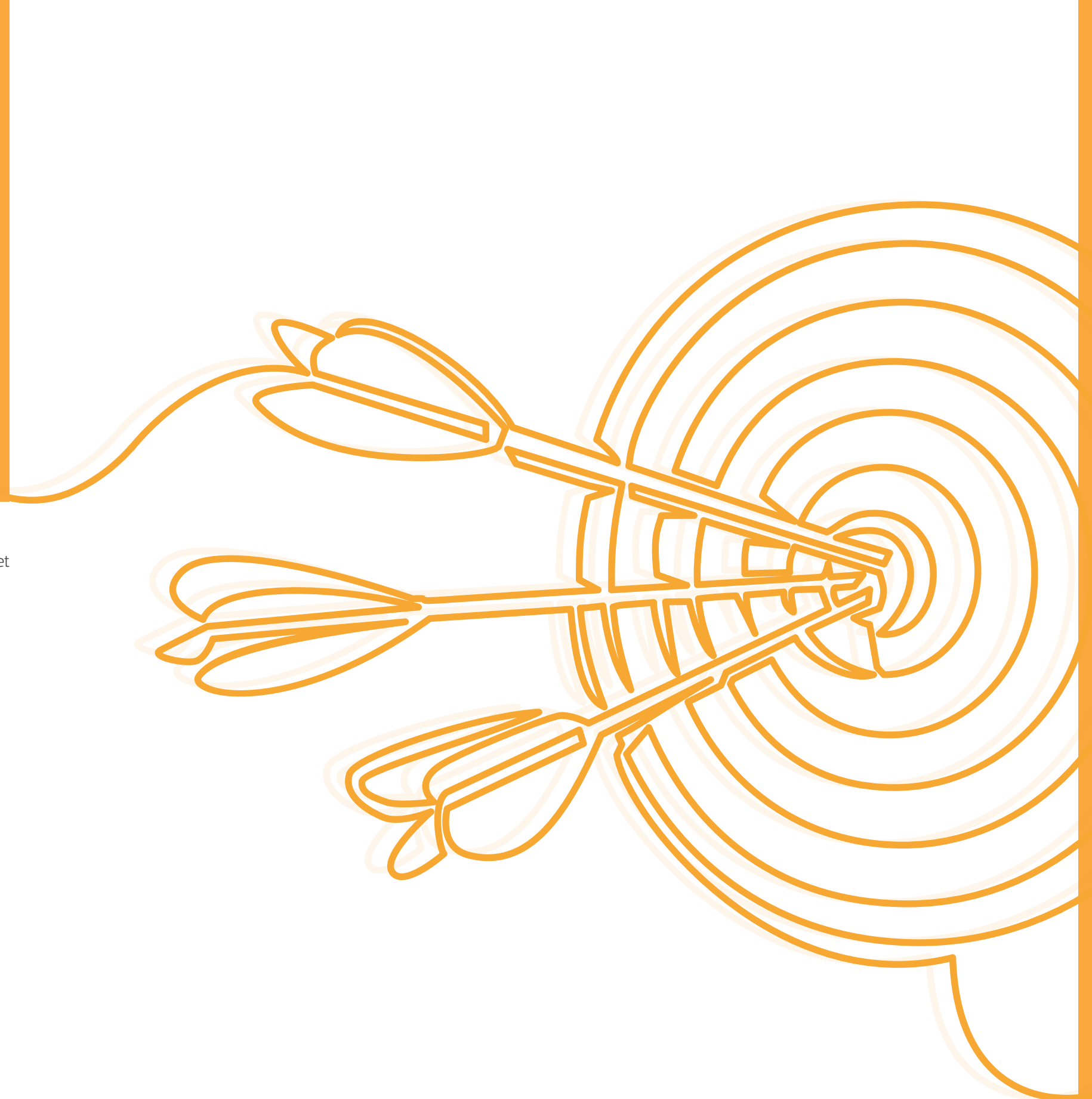
At this point, you should ideally have the following in place:

- an initial idea for what you want to do in the field of social finance;
- some human resources and funding to start your research and assessment.

An assessment of the environment, existing practices, organisations, support and needs should be the first step in the process of designing a social finance market instrument or initiative, just as before introducing a new recipe or product, you would like to know what the prevailing tastes and trends are, what ingredients are available and what is missing, how people have managed without your offer so far and why they would need/want your solution now. The assessment step may be very quick or fairly lengthy, but it is always worth the investment of time and even just a small amount of resources.

There are a number of benefits that a market assessment can bring. You can:

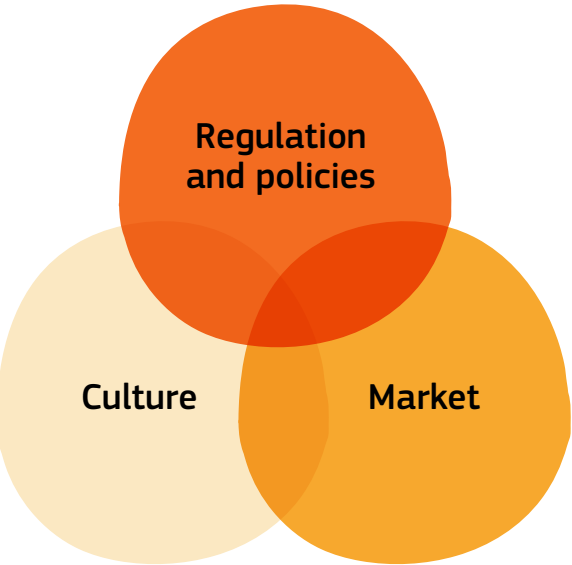
- gather information about the culture and regulations that influence the market;
- understand the language and the current state of affairs;
- identify and learn about key actors and stakeholders;
- learn from past and current programmes, schemes and models and their results;
- identify gaps: What are they? Why have they not been filled yet? Could you fill them?
- find potential future partners;
- decide whether there is space and need for you to launch your initiative;
- decide whether your initiative will bring added value or whether it might just be different or more efficient and/or potentially displace existing actors.



1.1. Enabling environment: Market, culture and regulation

Your market research should start with a closer look at the context and the environment in which social enterprises and their financiers operate. This environment has a number of components and depends to a great extent on the overall level of the development of the economy and the financial sector. This is not to say that one needs to perform a complete economic analysis of a country before engaging in social investment, but it is worthwhile to think about three main spheres of the environment (see Figure 2).

Figure 2. Main spheres of the environment



In the **regulation and policies** sphere, the interest is in laws and regulations governing the charity sector, possibly including specific regulations for social enterprise. A number of countries have introduced special legal forms for social enterprise (e.g. Finland, France, Italy or Slovenia), while in others there may be tax incentives favouring certain forms of social enterprise (e.g. social cooperatives in Hungary). A social enterprise strategy or other government strategies for social finance (e.g. social investment tax relief in the United Kingdom (UK), or the 90/10 solidarity savings

schemes in France) may be in place, which can directly influence the way the field develops. An important part of such strategies may be the allocation of specific funding (from EU or national sources) for social enterprises or to support infrastructure development. Policies affecting social services, care or environmental services may impact social enterprise development by providing or closing market opportunities for them. In Hungary, for example, a lot of care services have been nationalised and so social enterprises in these fields have lost their beneficiaries and their revenues. The removal of tax subsidies for renewable energy in the UK has also had an initial negative impact on those social enterprises running community energy schemes. On the supply side, there may be specific regulation in place for social investors (e.g. the European Social Entrepreneurship Funds – EuSEF – regulation) ⁽¹⁰⁾, tax incentives to encourage giving and social investment (e.g. in the UK) or government funding to boost the availability of capital on the supply side (e.g. in France and the UK). The key thing is to understand the relevant pieces of regulation, governmental policies and tax laws, and that these can be changed as quickly as they were introduced.

In the **culture** sphere, attention should be paid to the existence, or lack thereof, of philanthropy and a culture of giving; to the general openness of society to a social or environmental message; and to the existence of entrepreneurial, innovative thinking. For example, citizens in Sweden and Cyprus assign a greater importance to environmental issues than those who live in Austria or Croatia do ⁽¹¹⁾. Experience also shows that in markets with strong philanthropic traditions, social investors find partners more easily. On the supply side, relevant cultural aspects include innovative thinking in the financial markets and the existence of risk appetite. For example, if all investors prefer low-risk, low-return deals, high-risk social enterprise start-ups are unlikely to be funded locally.

A culture of collaboration is very important for both the supply and the demand sides, as a lack of such a culture may impede the development of potentially beneficial joint delivery or co-investment models.

In the **market** sphere, market access and success are key questions for the demand side: How open is the consumer and public market to purchasing from social enterprises and so helping to secure sustainable revenue-generating models? Is there targeted regulation that encourages certain customer behaviours, such as the Public Services (Social Value) Act ⁽¹²⁾ in the UK? Public sector markets may or may not be accessible to social enterprises, either for regulatory reasons or due to high barriers to entry. On the supply side, it is important to examine both the level of sophistication of the financial markets and the level of development of the specific social finance market. When the former is underdeveloped, chances are that the latter will be in an embryonic state because financing instruments and models that have not yet been tested in the mainstream are unlikely to be tried in the social finance arena, except by community-led or crowdfunding sources.

There are a number of ways to perform the environment assessment, desk research being one of the primary tools. At the same time, there can be more participatory and interactive ways to conduct your inquiry; a case in point is the online Better Entrepreneurship Policy Tool briefly described in the example below. Methods of assessment and possible conclusions are discussed in more detail in Section 1.5.

EXAMPLE: THE BETTER ENTREPRENEURSHIP POLICY TOOL

In 2018, a new online tool was launched to help stakeholders, especially public authorities, to assess the social enterprise ecosystem in their territory, be it national, regional or local coverage. The Better Entrepreneurship Policy Tool ⁽¹³⁾ has been developed jointly by the Organisation for Economic Co-operation and Development (OECD) and the European Commission and is available to stakeholders for individual or collective use. By assessing seven action areas, users are able to capture the state of development of the social enterprise ecosystem in their territory and, on this basis, design policies and programmes to boost social enterprise development and address the gaps and barriers identified through the assessment. The action areas overlap with the spheres of the environment discussed above, as they include the social entrepreneurship culture; social economy engagement; the institutional, legal and regulatory framework; skills and business development support; access to finance and markets; impact measurement; and reporting. The access to finance and markets action area includes social finance and also any corresponding regulations.

10 The EuSEF regulation, which entered into force in July 2013 and has since been amended, created a pan-EU marketing passport, with uniform criteria for all fund managers investing in social sector organisations (defined as 'social undertakings') through funds that meet the EuSEF criteria. Eligible funds need to have a measurable and positive social impact as their explicit focus. The regulation also requires EuSEF managers to have procedures for monitoring and measuring the positive social impacts that are to be achieved by their investments. The EuSEF label may only be used by fund managers that are fully transparent as to their investment policy and targets. Source: European Venture Philanthropy Association. n.d.a. Simmons & Simmons has developed a Tracker for revisions to the EuSEF and European Venture Capital Funds (EuVECA) regulations; see Simmons & Simmons elexica (2019).

11 European Commission (2017).

12 The Public Services (Social Value) Act 2012 came into force on 31 January 2013. It requires people who commission public services to think about how they can also secure wider social, economic and environmental benefits. Before they initiate the procurement process, commissioners should think about whether the services they are going to buy, or the way in which they are going to buy them, could secure these benefits for their area or stakeholders. Source: UK Government (2012); Cabinet Office (UK) (2015).

13 Better Entrepreneurship Policy Tool (2019).

1.2. What do social enterprises need finance for?

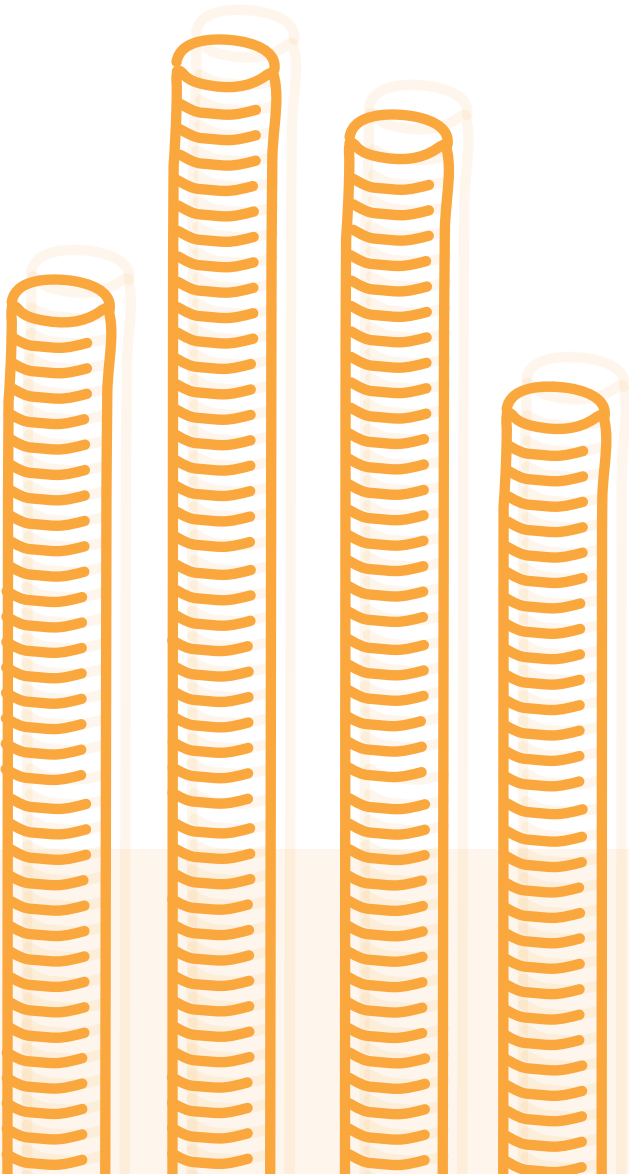
The demand side

1.2.1. Field of activity and legal form

Social enterprises work in various fields of activity, providing services or engaging in production. According to the Europe-wide mapping study ⁽¹⁴⁾, they can be grouped into the following sectors:

- social and economic integration of the disadvantaged and excluded (such as work integration and sheltered employment);
- social services of general interest (such as long-term care for the elderly and for people with disabilities; education and childcare; employment and training services; social housing; and healthcare and medical services);
- other public services (such as community transport and the maintenance of public spaces);
- strengthening democracy, civil rights and digital participation;
- environmental activities (such as reducing emissions and reducing waste or facilitating renewable energy);
- practising solidarity with developing countries (such as promoting fair trade).

Given that many social enterprises are innovative, it is not surprising that social enterprises are found in most areas of economic activity as we transition from the industrial world of the 20th century to an economy based on information and technology. Recent initiatives include ventures in ecotourism, information technology, publishing and financial services. Some countries limit the official recognition of social enterprises to certain fields by defining a legal form that is only permitted to act in certain areas, for example, those deemed of public benefit or work integration social enterprises (WISEs).



14 European Commission (2015a).



Before you set out on your journey, let's dispel a few myths...

- 1. Social enterprises are desperate for finance.** *They are not. Some want affordable finance, preferably unsecured, in relatively small amounts, where risk and reward are shared.*
- 2. Social investment is a source of income for social enterprises.** *It isn't and it has to be repaid.*
- 3. Social investment is new, untested and risky.** *It has been around on and off since the monte di piet  of 15th-century Italy.*
- 4. Social investment is only for large organisations.** *Wrong. Many transactions involve small sums to small organisations.*
- 5. Social investment is unaffordable for social enterprises.** *Not necessarily, particularly if the match with the product and provider is appropriate.*
- 6. Social investment is complex and difficult to understand.** *Not all deals are social impact bonds (SIBs) or hybrids. Most are straightforward loans, and smaller, equity-like structures can be made less complex.*
- 7. The crowd is too small for social investment.** *Wrong. Significant sums are raised across all platforms ⁽¹⁵⁾.*
- 8. Social investment only happens in developed financial markets.** *Wrong. It happens across Europe and throughout the rest of the world.*
- 9. There aren't enough deals to invest in.** *For a given stage of development of the market, there are plenty of deals, but both sides need support to make them happen.*
- 10. Social investment isn't for me.** *Maybe. But have you tried it or spoken to someone who has?*

15 According to the blog Fundly (n.d.), some EUR 5.26 billion was raised in Europe in 2017 across all market forms.

To sustain their mission, social enterprises need to become viable businesses without losing sight of their mission. As such, they have more commercial and investment-minded financing options open to them than other third sector organisations. They can use different forms and amounts of financing depending on their field of activity, stage of maturity and form of governance and what tools may be available in their country. The types of finance are covered in more detail in Chapter 3. It is clear, however, from many surveys (including one carried out by Social Investment Scotland on the pilot projects, see example in Section 1.5.4.), that although social finance and commercial finance for social enterprise has been available for some years, many social enterprises remain unaware of or disinterested in what is available or find it's not what they need. Many managers are financially risk averse and may steer clear of borrowing options in order to capitalise their enterprises. More recent research is hard to come by, but in 2014, CAF Venturesome found that only 3 % of charities screened had experience of borrowing and 61 % had no plans to do so in the future ⁽¹⁶⁾. Similarly, Lyon and Baldock analysed Social Enterprise UK (SEUK) data from 2013 and concluded that 65 % of social enterprises were not interested in repayable finance and only 15 % were seeking loan finance, with most borrowing from mainstream banks ⁽¹⁷⁾. Only 3.6 % of all social enterprises were approaching social

investors. In 2017, SEUK found that these figures had increased. 24 % of social enterprises had applied for loan finance, while 5 % sought equity ⁽¹⁸⁾. This raises important issues for investors and for policymakers seeking to increase investment in social enterprise and the cost effectiveness of their interventions.

Organisations active in the democracy-building and human rights fields tend to find it more difficult to create mission-related revenue-generating models and tend to rely more on grant funding or very 'patient' repayable finance. Property-based regeneration models or commissioning-based service-providing enterprises can use loans and equity investments more effectively if they can factor the cost of finance into their pricing structure. As will be seen later in this guide, some use is being made of outcomes financing to fund education, conservation and development projects where aid monies are redirected to outputs or outcomes rather than traditional input funding.

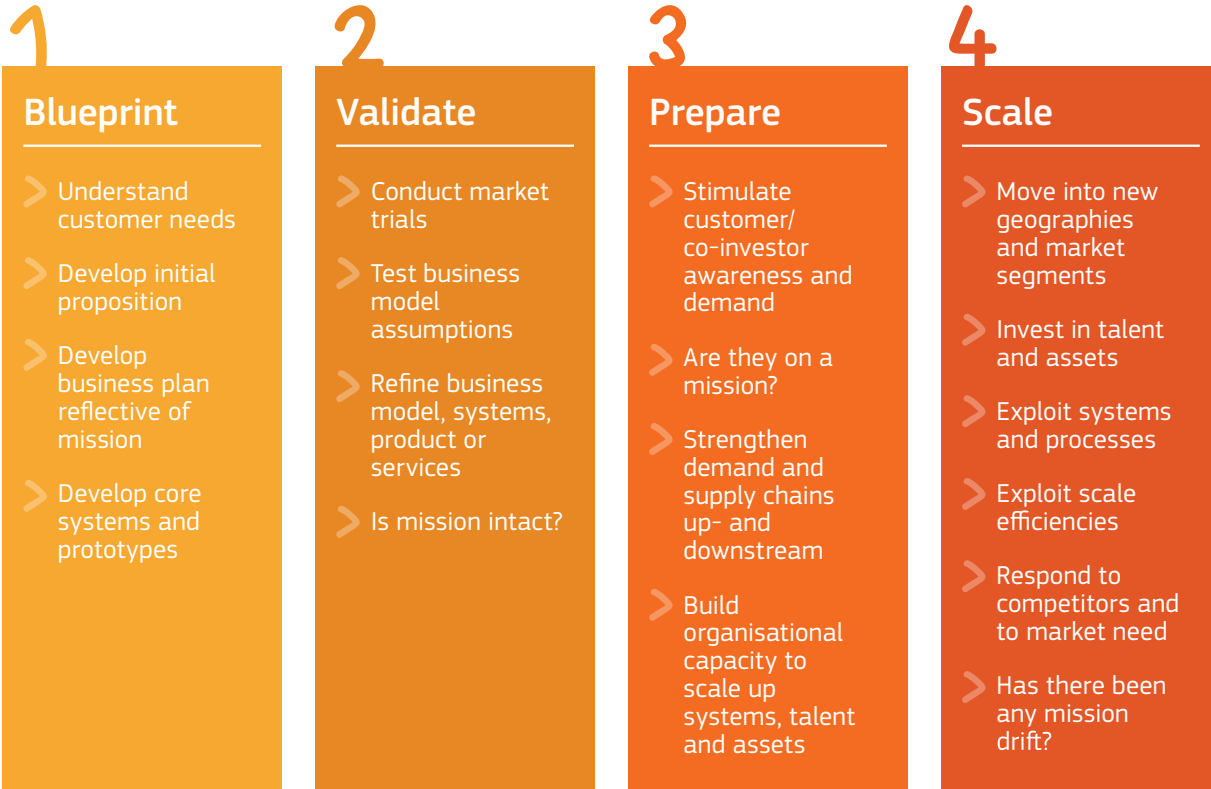
There is a wide range of legal forms that social enterprises can take across the EU Member States. These are explained in the glossaries at the end of this guide. The legal form of a social enterprise may be a decisive factor in its ability to access certain forms of social finance. Ownership and regulatory issues can also limit some enterprises' and non-profits' ability to access finance.

1.2.2. Stages of development of social enterprises

In general, social enterprises need funding at all stages of their development, from blueprint to scale. Figure 3 shows the four stages of the social enterprise life cycle and the key activities of the enterprise at each stage ⁽¹⁹⁾. Not all businesses go through these stages in a linear fashion; some will need to return to blueprint, if their model fails market trials at the validation stage, others will stop at that stage if scaling is not feasible. Renewal might be necessary at any stage, even if the enterprise is successful, for example, in order to respond to changing market conditions. Appropriate funding has to take this into account as well as the

changing needs of enterprises. As Koh et al. explain, few investors are willing to invest in the early stages of business development, so philanthropic funders are invited to close this critical gap. Philanthropy and money from family and friends can indeed get an enterprise through the blueprint stage and enable it to validate its model, but it will not be enough to fund the enterprise going forward. Although many investors care about social impact, few are impact-first investors so most are likely to have a primary goal of generating a (significant) social return on their investment.

Figure 3. Social enterprise life cycle
Source: Koh et al. (2012)



Note: The development of a social enterprise (just like any other enterprise) does not end with scaling. Observing the growth and demise of thousands of social enterprises would encourage the addition of a fifth stage to the above life cycle: namely a **closure or exit stage**. Closure does not need to follow scaling; it can happen any time after blueprint, if the business is unsuccessful or has served its purpose and achieved its intended impact.

Many social enterprises and, by association, the funds, investors and intermediaries who serve them, work with communities that are marginalised or excluded from the mainstream. They can face multiple challenges as a result, including: poor infrastructure, beneficiaries or customers with limited ability to pay, difficulties in attracting talent and often non-existent supply chains. These challenges are likely to mean additional costs and risks, with little ability to compensate for these costs and risks through high financial returns for investors. As a result, most investors avoid these enterprises altogether or decide to invest at a later stage.

16 Charities Aid Foundation Venturesome (2014).
17 Lyon and Baldock (2014).
18 Social Enterprise UK (2017).
19 Koh et al. (2012).

1.2.3. Purpose of finance

Social enterprises need finance for different purposes depending on their field of activity, business model and maturity. Money is most commonly used to finance working capital, for asset development (e.g. the purchase of property or equipment) or to build reserves or growth capital (growth capital could include the expansion of existing services or investment in infrastructure or innovation). Matching the available forms and amounts of finance with the desired purpose is a challenge in most markets because the risk and return expectations (both social and financial) of investors and investees do not often align. Grantmakers (public or private) are often reluctant to fund certain things. For example, EU grants historically available for social enterprise development (as opposed to the European structural funds for infrastructure development) have typically been reluctant to fund fixed asset purchases. At the same time, investors or lenders rarely have the patient capital or the flexibility to provide finance for a social purpose and on terms acceptable to the investee. Further discussion about the challenges in matching the demand and supply of finance follows in Chapter 3, where we look at the different categories of financial instruments. Table 1 lists the typical leading uses and sources of finance; it is based on the experience of Echoing Green's portfolio of 49 social enterprises ⁽²⁰⁾.

The following example of Impact in Motion illustrates how mapping the financing needs of social enterprises in Germany was the first step to identifying the financing gaps and developing an investment strategy to address those gaps.

EXAMPLE: IMPACT IN MOTION MAPS FINANCING NEEDS OF GERMAN SOCIAL VENTURES

Impact in Motion is one of the pilot project members whose objective was to explore models for a new social finance vehicle in Germany. When conducting market research, it found that social ventures in Germany seek finance for the following purposes throughout their life cycle ⁽²¹⁾: research and development (R&D); capacity building; real estate development; working capital financing; business expansion; knowledge sharing and public education; and transitioning to a new business model. The German National Advisory Board for impact investment (2014) showed that social enterprises often find it difficult to obtain financing for investments in 1) prevention, 2) innovation and/or 3) scaling. This gap in financing needs served as a key input to Impact in Motion's choice of vehicle and the design of its investment strategy. Shortly after the conclusion of the project, Impact in Motion merged with PHINEO and, based on findings from its first project, work was started on a 'social tech seed fund'. This later evolved into a 'tech4impact fund' with support from partners and also funding from the European Commission.

This seed impact fund has a target volume of EUR 15-20 million, with the goal of obtaining commitments of EUR 5-10 million for an initial first close. In the second funding round, PHINEO developed an investment strategy, a comprehensive impact management framework and marketing materials, and built a preliminary pipeline of potential investment targets as well as potential fund investors (LPs). At the time of writing the second edition of this publication, they are in the process of finding strategic partners and further funding in order to implement the marketing and fundraising phase.

20 Given the relatively small size of the social enterprise market (compared, say, with the traditional small- and medium-sized enterprise market), and the undeveloped nature of research in this area, sample sizes are often small.

21 Choi and Mummert (2015)

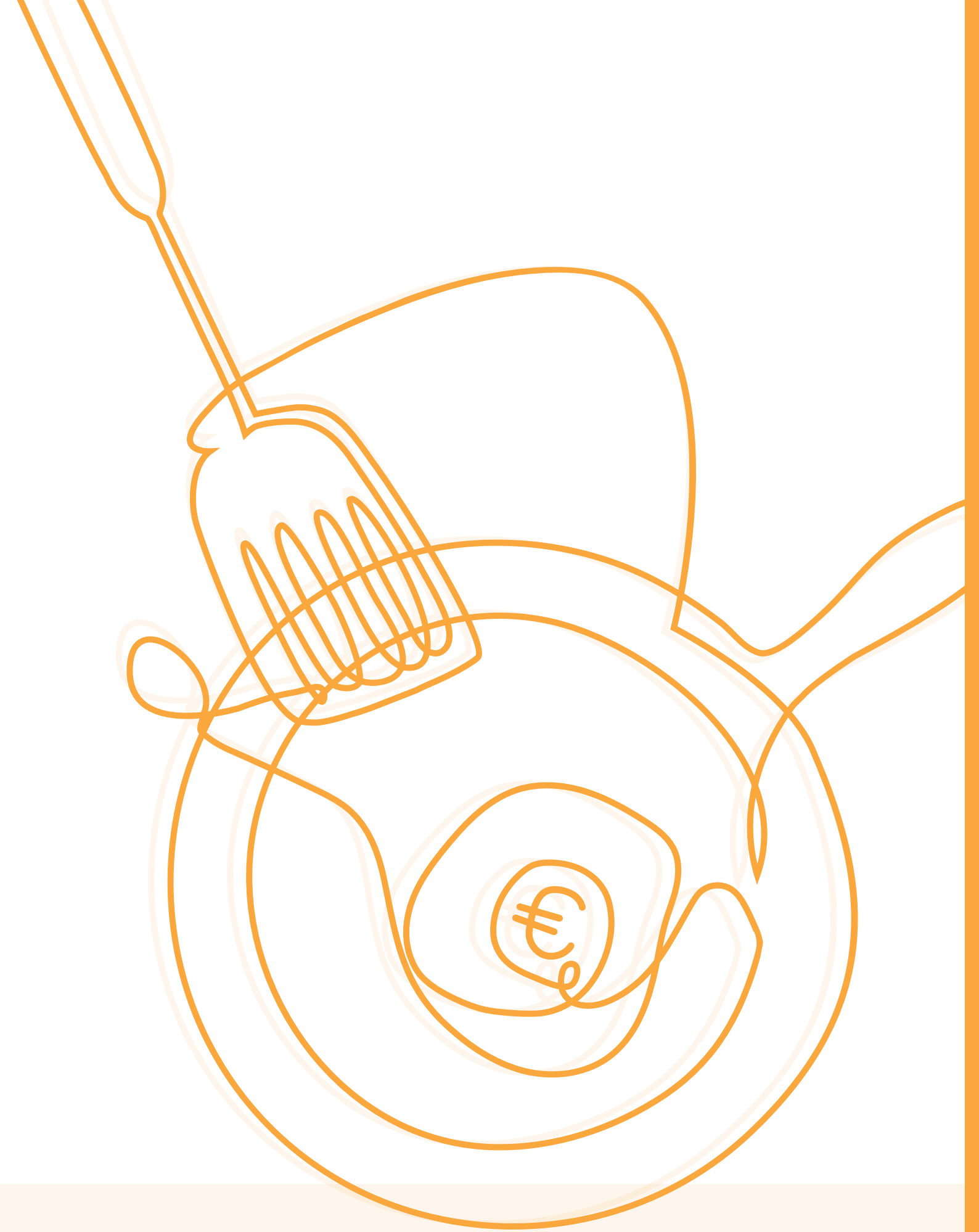


Table 1. Top uses of capital by instrument type and the top sources of capital
Source: Echoing Green ⁽²²⁾ (2017)

Instrument type	Top current uses	Anticipated uses over the next 2 years	Observations
Self-funding	- Working capital - Salaries - R&D - Capex (capital expenditure)	None reported	Working capital predominates in the seed and growth sectors. Capex more frequent in early, growth and scale segments.
Grant	- Salaries - R&D - Working capital	- R&D - Salaries - Marketing	Only entrepreneurs in the early and growth segments cited using grants for inventory.
Convertible debt	- Salaries - Capex - Working capital - Marketing - R&D	- Salaries - Marketing - Working capital - Capex	No standout top issues except that salaries were the leading use in seed and early segments. Convertible debt was used for inventory almost exclusively in the growth segment.
Debt	- Working capital - Capex - Salaries	- Working capital - Capex - Salaries	Anticipated use of debt for capex highest in the early and growth segments. Salaries become a less common use of debt in the growth and scale segments.
Equity	- Salaries - Marketing - R&D	- Marketing - Salaries - Working capital	Inventory was more often a use of equity in later-stage enterprises.

Top sources of capital	Now	Future	Observations
Grant	- Foundation - Accelerator/incubator - Government	- Foundation - Government - Family office	Only type of corporate funding was grants, all in the early and growth segments.
Convertible debt	- Family office - Foundation - Fund	- Family office - Fund - Corporate - Foundation	Almost all the convertible debt from funds was in the early and growth segments.
Debt	- Bank/financial institution - Family and friends - Foundation	- Bank/financial institution - Foundation - Fund	A bank/financial institution was found to be the default provider despite other approaches.
Equity	- Family and friends - Family office - Fund	- Fund - Foundation - Family office	Three growth-stage entrepreneurs raised equity from foundations, while 17 were planning to. Only one got equity from a bank.

22 Echoing Green is a 30-year-old US non-profit organisation that develops social impact leaders. Fellows leading hybrid and for-profit businesses are awarded recoverable grants, whereas non-profit leaders receive outright grants. Source: Echoing Green (2019).

1.2.4. Viable business models

A vibrant social investment market cannot function without viable social enterprises that have robust business models with revenue-generating potential and measurable social impact. One of the most significant barriers to the development of social enterprises and their attractiveness to funders is their lack of convincing business plans and sustainable business models. Social enterprises often work in weak, fractured or non-existent markets, providing services where very few purchasers are prepared to pay for the value that the social enterprise can create. As a result, social enterprises often develop their financial plan on the basis of cost recovery, rather

than the generation of a surplus for reinvestment. The majority of social enterprises also lack formal business planning and implementation skills, especially in the early stages; hence the importance of capacity-building organisations, consultants and incubators that can help start-up companies to take the first steps. If these support organisations are absent or do not have enough capacity to supply social enterprises with expertise and training, investment opportunities may be wasted if investors and entrepreneurs are not ready for each other and opportunities are lost in translation.

1.3. Characteristics of social investment: The supply side

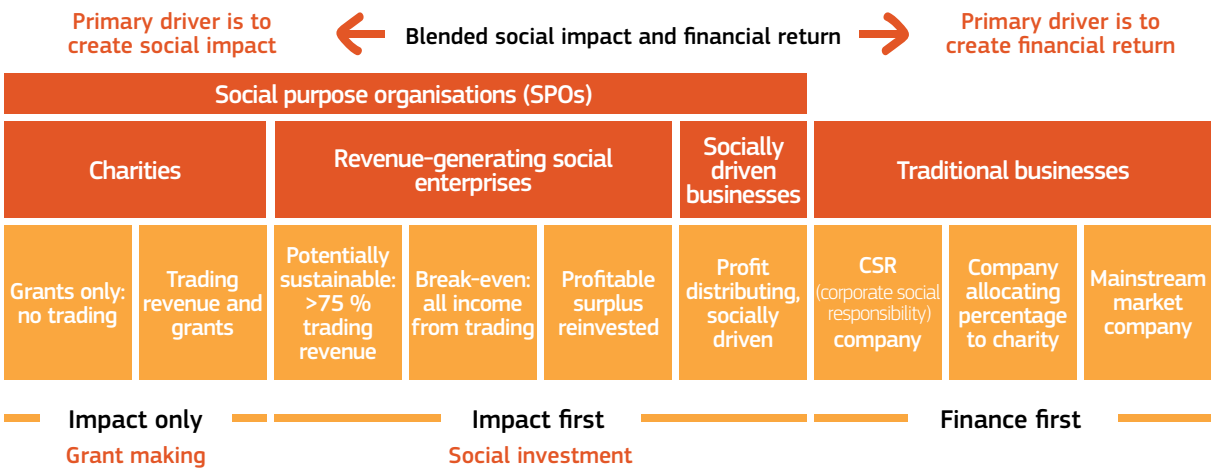
1.3.1. Why is social investment different from mainstream investment and how can it meet the needs of social enterprises?

Classical mainstream investment can be defined as putting your money to work in order to increase (maximise) your earning potential, in other words, the act of committing capital or money to a project or business with the expectation of obtaining income or profit; the focus is on private investor returns. It would be quite feasible to invest in a social project in the same way, but the motivation of the investor is solely that the investment offers an attractive rate of financial return.

Social investment is where the focus of the investment (financial and non-financial) is on the social, environmental, cultural and economic benefits of an initiative, on the organisation’s work and on the health of society as a whole. However, the types of investor can be distinguished according to the

relative weighting of financial and social objectives. Figure 4 shows a spectrum of expected returns from a modest or marginal social return, to a situation where the emphasis is on the social return entirely and therefore no financial return is expected. At this end of the spectrum (impact only or impact first), there may be no expectation of capital repayment either, and the appropriate instrument may be gift money. At the same time, impact investing aims to generate financial as well as social return (see the Glossary of other terms). Venture philanthropy covers the impact-only and impact-first sections of the spectrum. On the other hand, the finance-first end of the spectrum includes traditional businesses, which attract investors whose main driver is financial return. This kind of investment is not considered social investment, even if social impact happens as an unintended consequence.

Figure 4. Investment spectrum
Source: European Venture Philanthropy Association (2018)



Referring to the Global Sustainable Investment Alliance, *The Economist* argues that the different strategies to obtain social and financial return are all variants of **sustainable finance**, a nascent space but one in which over a quarter of all assets under management take account of environmental, social and governance issues, although some 60 % of these are simply negatively screened ⁽²³⁾. An **ethical investor** will be an investor in mainstream companies or funds for commercial return that favour conscious positive impact policies and/or avoid creating social damage. **Impact investors** invest in organisations that are not only doing well, but are also making strong financial returns (sometimes improved by benign fiscal policies). This might include people who invest in for-profit renewable energy companies, for example. Impact is essential; but so is financial return. Most impact investment is predicated on the assumption that financial return need not be sacrificed in pursuit of non-financial return. Each of the different types of responsible investment has its part

to play, so the model investor may have a portfolio that comprises several, each with different criteria and differing approaches to the relationships with investees and other investors and how, for example, they might react in the event of a default.

The key point is that the definitions relate to you as an investor, not to the characteristics of the investment. **Being a social investor is about attitudes, not asset classes**. When you do your research into investment types, make sure that you compare like with like. Large figures are bandied about for the amount of sustainable finance being provided, but social investment forms only a small part of these figures.

Social investment is not just about finance and intermediary support. It is also about finance that attracts citizens of a like mind and similar values. It will be for you to determine a definition that suits you and where you wish to sit along the spectrum of return.

1.3.2. Is it always appropriate or at the right scale?

Social enterprises are not natural borrowers; however, current circumstances are making them think differently ⁽²⁴⁾. A change in government priorities, more restricted grant funding and greater scrutiny from donors have forced many social enterprises to look for alternative ways to finance their activities, while others have ‘jumped before they were pushed’ and looked for new ways to kick-start new operational models. But some social enterprises are mainly – sometimes only – interested in obtaining money on the most affordable and least restrictive terms possible. This kind of finance is unlikely to be available from the local commercial bank unless no other source is available. Social finance can meet the needs of social enterprises by providing generally simple and easily understood structures and by being more flexible regarding the terms on which the finance is provided. The level of flexibility is likely to be related to the source of the funds.

Values-based banks (sometimes known as social or ethical banks) are large providers of finance to social enterprises who have long understood that banking is a combination of both responsibility towards society and of making a reasonable profit to generate fair livelihoods. Nevertheless, values-based banks still have a primary obligation to protect the savings of their depositors. They do not have the flexible risk appetite that would allow them to provide higher-risk social finance. Foundations can, perhaps, be natural partners in the provision of layered finance by taking the first or higher risk, but they remain a small minority, with most seeing grants as their only financial tool. In any case, as with venture philanthropists, there are simply not enough of them to meet the long-term life cycle needs of social enterprises.

However, social investment is not right for every enterprise, and even where it is, it may be a challenging and time-consuming process. Assuming that most social finance has to be repaid, then the enterprise will need a reliable source of income to repay the investor. This tends to favour the growth of already-successful financial models, which may be run by the trading

arms of charities, associations or non-profits. Where the non-financial returns look strong, social investment can also open up access to finance for enterprises that lack the asset cover to access support from classical financial providers. It can also help to leverage further funding by demonstrating, through its due diligence process, belief in the viability of an organisation and/or the achievability of the social returns.

Another issue is scale, one of the challenges highlighted in the example of Serbia. Established social investment funds, particularly those that have to bear the cost of regulation, tend to drift towards larger deals as their portfolios mature, and they find it increasingly difficult to adapt their model to finance small-scale need in a cost-effective way. Numerically, the greatest financial need is for small amounts of money (less than EUR 250 000; often less than EUR 50 000) ⁽²⁵⁾, which may be more appropriate for small-scale individual investors or the crowdfunding market. At the other end of the spectrum, some of the largest finance needs are just too large for the nascent social investment market. Major infrastructure or fixed asset investments or developing new ways of addressing societal needs can be expensive and may require a significant amount of financing. Social investors are geographically dispersed and often operate in discrete markets. Perhaps as a result of their different roots and missions, social investors also do not syndicate investments among themselves at the scale that commercial banks do.

More recently, a few very large impact investment funds have emerged. The Rise Fund ⁽²⁶⁾ was launched in 2017 by private equity company, TPG ⁽²⁷⁾ with USD 2 billion to ‘direct this beast called capitalism and help to direct it in a way that is productive’. That ‘impact multiple of money’ can be delivered in ‘increased income for smallholder farms, reduced greenhouse emissions, lower costs through diabetes prevention, or other quantifiable social goods’. The Rise Fund’s investors include a roll call of ultra-high-net-worth philanthropic investors, but also pension funds,

sovereign wealth funds and university endowments, some of which are new to impact investing. This is investing at institutional scale. It is targeting societal change through upscaled or new business models.

EXAMPLE: MISMATCH BETWEEN DEMAND AND SUPPLY FOR FINANCE IN SERBIA

Smart Kolektiv implemented a pilot project in the 2016–2018 round of the EaSI support programme, aiming to build partnerships and models for the sustainable development of social finance in Serbia. It focused on the supply side, but significant piloting and investment-readiness work was also needed by a select number of social enterprises. Smart Kolektiv implemented the project in partnership with Erste Bank and Oksigen Lab.

As a first step, Smart Kolektiv conducted research to map out the challenges and needs of social enterprises in obtaining finance and to assess their readiness for social investment. A sample of 40 enterprises was surveyed, of which 37.5 % were said to be in the validate phase and 30 % in the prepare-to-scale phase of their life cycle. Financing needs of surveyed enterprises differed by phase, the majority (70 %) requiring EUR 10 000 to EUR 100 000 for the implementation of their plans. Research highlighted the mismatch between demand and supply and a possible knowledge gap on behalf of social enterprises: of those requiring up to EUR 25 000, 71 % said they were in the prepare-to-scale phase, while of those that wanted over EUR 50 000, half were start-ups.

The assessment included the supply side of social finance in Serbia, reviewing the few players that are active in this market: the government, which offers a few public schemes; two banks; microfinance; and a handful of grant programmes supported by local and foreign foundations. Research findings reiterated that ‘the Serbian financial framework for SMEs and social enterprises is underdeveloped in a number of important aspects’ ⁽²⁸⁾.

Throughout the project, Smart Kolektiv organised a number of consultations with key stakeholders and did significant work to raise their awareness of and capacities regarding social finance. As a result of the research and the stakeholder consultations, Smart Kolektiv was able to produce a number of recommendations. It also initiated a pilot lending programme jointly with Erste Bank Serbia to test the absorption capacity of social enterprises that had received capacity-building support. Research, the pilot and roundtable discussions validated Smart Kolektiv’s concept for a sector-wide initiative and lent credibility to the project. The final output is expected to be a memorandum of understanding (MoU) signed by a number of investors who would commit to launching the first social finance fund and to implementing other recommendations for the development of the social finance market in Serbia.

24 In the UK, voluntary income to the third sector has fallen by nearly EUR 3 billion since the 2007–2008 financial crash, while grants from the government have halved in the same period.

25 In the post-2008 world, there is an estimated EUR 34 trillion shortfall worldwide in the funding of micro-, small- and medium-sized enterprises, including social enterprises. Source: World Bank (2015).

26 The Rise Fund (2019).

27 TPG is a service mark of Tarrant Capital IP, LLC. Source: TPG (2019).

28 Spear et al. (2013).

1.3.3. Characteristics of social investors

Social investors, unlike mainstream investors who happen to finance social initiatives, view their investments holistically; they understand the impact that their financial decisions have on the world. Their values are built upon transparency, sustainability, fairness, diversity and inclusion. Social investors live

the triple bottom line and can more readily relate to the needs and experiences of the enterprises in which they may invest. This means that, compared with the mainstream, social investment offers a more empathetic approach. While these are the general features of social investment, national ecosystems of social finance can vary a great deal by country, as explained by the examples of Spain and France.

EXAMPLE: THE SOCIAL INVESTMENT LANDSCAPE IN SPAIN

Over the last five years or so, there has reportedly been an exponential growth in the Spanish social investment market⁽²⁹⁾. However, it is again important to consider terminology here, as these growth figures may include socially responsible investment (SRI) funds. The tradition of social involvement in Spain comes from different roots. Founded in 1943, Mondragon is the largest cooperative group in the world. Its sister cooperative, the credit institution Caja Laboral, is currently partnering with the European Investment Fund (EIF), the Government of the Basque Region Country and the local Employment Service to offer unsecured loans up to EUR 25 000 for a new generation of enterprises. Social finance has been provided beyond the Basque Country through values-based banks such as Triodos, which has a branch network, and more recently, the Italian Banca Etica, in partnership with the Spanish NGO Fiare. The Spanish regional cooperative banks also provide some social sector lending.

At the other end of the spectrum, Creas is a foundation that provides finance and the expertise of their professionals and networks through the social venture capital funds Creas Inicia and Creas Desarrolla. Creas seeks both economic returns and positive social impact, and it works through social enterprise networks. The foundation Ship2B has developed the 'B-Ready' programme to accelerate social impact start-ups by providing 'networking, mentoring, financing capacity building and visibility services'. It also runs a complementary EUR 1.5 million fund, has a large investor network, and has secured co-funding from the EIF. In this context, the social enterprise ecosystem is developing. Specialised impact funds like Gicoop in Barcelona, which provides a solid mentoring service, are covering specific gaps, while foundations including Social Nest and UnLtd Spain work to develop deal flow. La

Bolsa Social is the first equity-based crowdfunding platform in Spain for impact investment.

One obstacle to the social investment landscape seems to be access to finance. Spain has many regions and cultures, with each autonomous region and even some cities having their own approach to promoting the social economy. The second cohort of EaSI pilot projects included two from Spain – one from Madrid and another from Barcelona – both seeking to address the issue of access to finance in different ways. In Madrid, the project Customised Investment for Social Enterprises carried out by Fundación Isis has concluded that an investment vehicle for start-ups and early-stage social enterprises alone is not viable, but can become so if it also engages with more established social businesses. The Social Investment Ready Project in Barcelona carried out by Gicoop has sought to reduce the transaction costs in the finance of social enterprise by enabling enterprises to become more investment savvy while also training social investors to have a more standardised approach to due diligence.

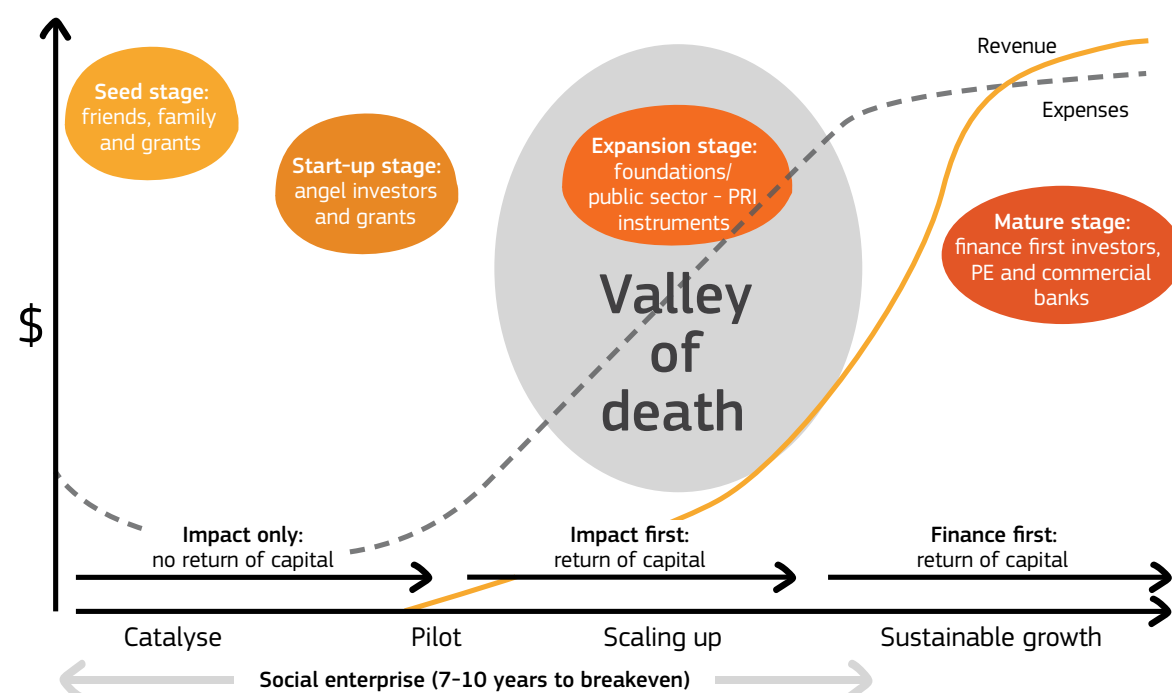
Nonetheless, key challenges remain. Despite the various initiatives referred to above, there is a lack of awareness towards the concept of social enterprise and, consequently, the appropriate ways to finance it. As with other countries, there is a disconnect between what investors expect of social enterprises and vice versa. As a result, it appears as though access to finance is limited. At a state level, the Instituto Oficial de Credito (ICO) issued the first SIB in 2015 to create countercyclical employment in the regions and followed it with a second in 2016. Overall, however, there is a lack of support from government and a lack of adequate social public procurement practices.

Social investors range from angel investors to funders of large-scale initiatives. They could be venture philanthropy funds, charitable foundations or loan or investment funds. Social investors also include financial cooperatives and cooperative banks, credit unions, funds of varying types and motivations along the impact spectrum, affluent or high-net-worth individuals (sometimes incentivised by tax breaks) and other individual retail investors. Crowdfunding (in its various guises) and community shares have brought social investment to less affluent individual investors. Figure 5 places these different social investors along the impact-first to finance-first range, and also points out where the main gap is between demand and supply of finance: the ‘valley of death’.

Individually, social investors are likely to bank with values-based banks, building societies, cooperative banks or mutual or other ethical financial institutions. They will also save with these organisations, as well as investing their savings in microfinance funds and tax-incentivised forms of social investment. They may buy charity bonds and buy directly from social enterprises. Social investors are also likely to invest in community and social enterprise share issues, or may provide guarantees. Institutionally, as direct investors or as intermediaries, social investors make secured and unsecured loans, buy SIBs and charity bonds and work with social enterprises in their supply chains. They also put effort into raising awareness about social finance and social enterprises.

Figure 5. Range of social investors in growth stages of social enterprises

Source: Bolis et al. (2017)



EXAMPLE: SOCIAL INVESTORS IN FRANCE

The French term *finance solidaire* (solidarity finance) encompasses all financial opportunities that allow individuals to invest directly or indirectly in a project or social enterprise with a strong social and/or environmental objective.

Solidarity finance has its roots in France in 1983 when the first social mutual fund, Faim et Développement was launched ⁽³⁰⁾. Today, there are a large number of different types of social investors across a wide spectrum in France: individual investors using the solidarity savings schemes (see Chapter 3); large corporations using dedicated funds, such as Danone and Schneider; high-net-worth individuals who use risk-based capital funds, such as Phitrust and Investir; non-profit microlenders, such as Adie; investment clubs, such as CIGALES and Clefes;

financing companies, such as Caisse Solidaire du Nord pas de Calais, France Active Garantie and La Nef, as well as credit unions and mutuals; land organisations, such as Terre de Liens and Habitat & Humanisme; and overseas investments such as the International Solidarity for Development and Investment (SIDI). Indirect investment in social enterprises is the most frequently used route of social investment. Solidarity finance has been legally regulated since 2001, although a solidarity finance label, Finansol, had been introduced four years earlier ⁽³¹⁾. Investment clubs see themselves as start-up engines, providing around EUR 2 000 per financing deal, while other investee enterprises may graduate up to Ides, France Active Garantie or La Nef, where loans may exceed EUR 2 million ⁽³²⁾.

1.3.4. Forms of investment and their appropriateness

One pillar of mainstream finance theory is that the rate of financial return increases with risk. For the financing structure of social enterprises, there is no similar relationship. A growing number of financial instruments are being designed to try to address the funding needs of social enterprises and to bridge the gap between social and financial return. Hybrid corporate forms have also been developed to address the issue of balancing mission and mainstream equity.

Social investment can be made in the form of debt or equity instruments, or as hybrid models incorporating both of these forms plus grants. Excluding gifts and grants, debt instruments are currently the most widely used form of social investment. Guarantees are contingent liabilities that will only become debt or equity if called. For the purpose of market

assessment, Table 2 provides a summary of the most widely used forms. A discussion of the choice of financial instruments follows in Chapter 3, and a more complete list of the instruments – both those in use and some that have been proposed – can be found in the Glossary of financial instruments at the end of this guide, together with the authors’ (subjective) rating of their feasibility and relevance, where appropriate.

Outside the formal structures of direct investment and intermediaries, there is an informal social finance market – made up of family and friends, trustees and board members – that often provides low- or zero-interest loans with documentation rarely extending beyond a page (if that).

30 Finansol (2018a).

31 Finansol produces an annual overview of the solidarity finance market, Zoom; see Finansol (2017).

32 Survey by OpinionWay in 2012, quoted in Guezennec and Malochet (2013) and additional information in 2018 from France Active.

Table 2. Forms of investment

Form of investment	Key features
Secured loan	• Loan given against a security that can be repossessed if the loan is not repaid; the security may be tangible (e.g. bricks and mortar) or intangible (e.g. cash flow, guarantees or intellectual property) • Funds working capital, growth, asset purchase or other specific projects
Unsecured loan	• Short-term bridging support pending a specific payment event, e.g. grant receipt • Higher interest rate than secured loan, but may be the only option in an asset-poor situation • Funds working capital or development capital (e.g. capacity or scale)
Charity bond	• Tradable debt (may only be notional) with periodic interest payments • Usually for larger needs (over GBP 1 million) • Can fund building-related or income generation projects
Equity	• Investor owns a stake of the investee organisation, usually in the form of shares • Can provide risk capital to early-stage organisations, as well as to more established organisations looking to go to scale • Not as common as debt due to governance and structure limitations • An option may be ‘quasi-equity’, where investors receive variable repayments often linked to revenue (see Chapter 3 for more detail) • Investment may come with add-on support, such as capacity building
Guarantee	• Contingent risk, so no money is provided up front; the investor can keep their money invested at interest, unless they are required to deposit with the lender (cash-backed) • Can take many forms: performance, advance payment, usually 50-80 % of risk • On demand or conditional

1.4. Other key elements of the social investment ecosystem

1.4.1. Other partners and stakeholders

Social enterprises and social investors are not the only players in the market. Your assessment will identify a range of other stakeholders, each playing different roles and each positioned in or across different segments of the market. Some are game changers, while others are influencers or mere participants. An assessment of these stakeholders and of their relationship to each other and to you can serve to indicate possible future collaborations. It is important to find out not only who they are, but also how many there are; their interests, motivations and needs; and the resources at their disposal. Some of the stakeholders may have already formed partnerships or coalitions, which you will want to be aware of. The presence – or lack – of certain stakeholders may also be an indication of the level of market development. Intermediaries, for example, play a bridge role between investors and potential investees, and their absence may stifle market development.

The public sector and government are special players in the social investment market. They often determine the legal and commercial framework within which the market can operate. Government can be a great enabler and supporter of market developments, for example, through the provision of additional funding and tax incentives or by improving visibility of new initiatives. However, if the government sends out contradictory messages, for example by promoting a very narrow definition of social enterprise, it can inhibit development. The public sector can also act as a purchaser or customer of social enterprise services, thereby contributing to a sustainable revenue-generation model, which in turn attracts social investment. Revenue-generation models dependent upon state purchases, however, can create over-dependency which then causes problems if the state changes its purchasing behaviour. In countries where

EU public procurement directives are not transformed into local legislation, or where commissioners do not implement the favourable public procurement rules, social enterprises do not have access to public sector contracts, and thus the growth of the social enterprises has been limited significantly (as, for example, in some Central European countries).

The most common stakeholder groups on the supply and demand sides of the market are presented in Table 3.

An analysis of the key stakeholders can help you decide your strategy: ***Are there significant gaps or distortions that will make your contribution welcome? Or is it the opposite situation? Are there dominant players who may make it difficult to enter this market? If you are planning to play a facilitator or intermediary role, which players will you need to connect with and how?*** If you are looking at a nascent market, the role of the government can potentially be a very important factor in encouraging investors and investees by offering enabling legislation, incentives and funding. If the government’s engagement is low and the resources it allocates are insignificant, market actors can struggle and development may be very slow. Governments in other contexts, on the other hand, may be *too* active, for example, if they squeeze out private investors by dominating the funding market, or nationalise the provision of services, which reduces the potential market for social enterprise service providers. This again may lead to slow market development and struggling social enterprises that are unable to generate promising business models.

Table 3. Stakeholder groups on the supply and demand sides

Note: Intermediaries may appear on both or either the demand and/or supply side.

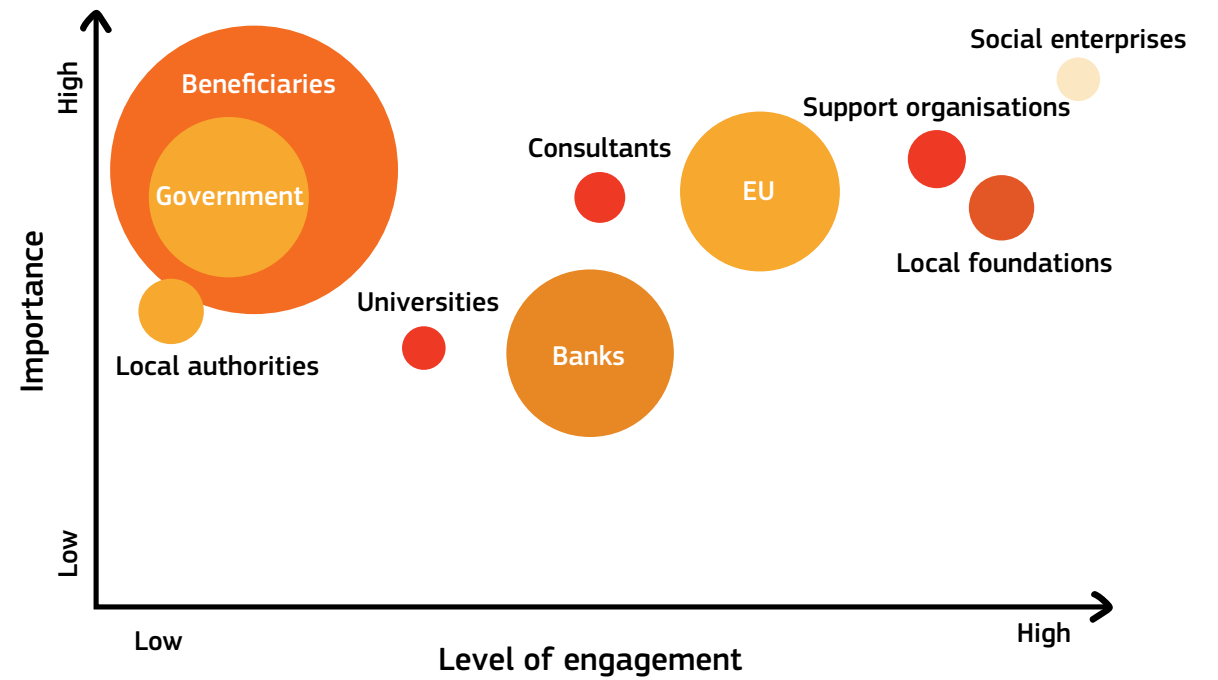
Demand side	Those that demand finance and support services
Social enterprises/investees	• Social enterprises • Charities • Cooperatives • Associations
Beneficiaries/customers/members	
Supply side	Those that supply finance and/or support services
Public sector	• Government ministries, (development) agencies • Local authorities, commissioners • EU funds-managing authorities
Academia	• Researchers • Trainers, professors • Schools • Think tanks
Financiers	• Private trusts and foundations • Individuals (including donors) • Corporations and their foundations • Values-based banks • Venture philanthropists, social investment funds • Commercial banks • Savings and cooperative banks • Impact investing funds • Crowdfunding and other platforms • Umbrella organisations made up of the above
Expertise	• Intermediaries • Support organisations and networks • Consultants

A more detailed explanation of finance providers is included in Chapter 3, while an explanation of support organisations and intermediaries in Chapter 4.

Stakeholder analysis will also be important for the social impact management cycle in this book (see Chapter 6), so a timely assessment of these key groups will provide input and baseline for the impact process as well.

Figure 6 shows typical stakeholders in a hypothetical market positioned along the ‘importance’ and ‘engagement’ axes. The size of the bubbles indicates resource availability (not necessarily resources used) of the various stakeholders.

Figure 6. Stakeholder positioning in country A



1.4.2. Support infrastructure

While a private sector business may manage with just a business plan, a social enterprise needs to demonstrate not only that its commercial plan is viable (if indeed it has one), but also that its social and environmental aims are both achievable and verifiable. This ‘triple bottom line’ approach requires specialist capacity-building, non-financial support rather than generic small- to medium-sized enterprise consultancy.

Very few charities and start-up social enterprises, however, have a business strategy or are ready to absorb social investment. They are experts in their social fields and are often very entrepreneurial, but they need support in their formal business planning, governance and development activities in order to realise the full potential of their enterprise idea.

The typical menu of non-financial services consists of:

- business strategy support
- access to networks and contacts
- specific resources and services.

Specialised consultants (non-profit or for-profit), legal advisors and tax and accounting firms may provide the above support and services, while financial and non-financial intermediaries or funders may offer capacity-building or investment-readiness programmes in order to strengthen the potential investees. These programmes and intermediaries are covered in more detail in Chapter 4.

Social enterprise networks, coalitions and other umbrella bodies are also very important parts of the support infrastructure. They often provide specialised services, databases, certificates, templates and documents that social enterprises can use. They organise events, facilitate networking and often represent the voice of social enterprises at regional or national level. The existence of such networks and coalitions is shown to have accelerated the development of social enterprise sectors where they already exist, and have contributed to the growth of the social finance markets as well. Social Enterprise NL, a national membership body representing 300 members, offers a number of such services as well as conducting an annual survey of social enterprises in the Netherlands ⁽³³⁾.

Apart from support organisations, investors themselves often provide non-financial support to the social enterprises they have invested in or intend to invest in. This support may have risk mitigation as its main purpose; investors focus on their investees’ success in generating the expected social and financial returns, so they offer non-financial support to make that success happen. Investors are also often willing to mobilise their networks, create market synergies with other investments, leverage other financing, provide supply chain contacts or market access, or give industry-specific advice.

1.5. Conclusions of the market assessment

1.5.1. Where are the gaps?

The assessment of what already exists in the market should highlight the various gaps and opportunities. The gaps most likely to be highlighted fall into the following categories.

- 1. Knowledge and skills gap:** This gap is probably the easiest but also the most time-consuming one to fill. Knowledge and skill gaps are major barriers on the investee side, for example when social enterprises are unable to build a business model or run their operations efficiently. Knowledge gaps can appear on the investor side as well, as many social finance suppliers do not understand the social goals and measurement tools of the potential investees and thus set unrealistic expectations based on their knowledge of how mainstream markets operate. These gaps can be filled in many ways: 1) buying in the services of paid experts and support organisations to work with the investees; 2) forming partnerships that bring the missing skills to the table; and 3) designing and implementing a capacity-building programme.
- 2. Financing gap:** The financing gap may mean a lack of sufficient funding available to meet market needs, a lack of certain types of financing products and favourable conditions, a lack of specific financing/investment ranges or a lack of a secondary market. A typical problem

encountered by social finance markets is the existence of the ‘valley of death’, i.e. the lack of investment available for the start-up or consolidation of enterprises. In the experience of NESsT, an investor and support of social enterprises, in Central Europe this is up to the EUR 100 000 level; Impact in Motion in Germany similarly found limited availability of capital in the EUR 100 000-500 000 range, while Impact Hub in Milan reported a gap in transition finance of between EUR 100 000 and EUR 200 000. Regardless of the amount, this money needs to be available at the right time and on the right terms.

- 3. Regulatory gap:** The regulatory gap usually means a missing piece of regulation, which can be either a ‘show stopper’, or something that could simply slow down the development of the market.

The next question to answer will be whether someone – either you or another actor in this market – is likely to fill these gaps. Gaps may be showstoppers (e.g. complete lack of financiers in a given country) or they may present a unique opportunity (e.g. nobody has yet set up a social enterprise loan fund). Adding the last piece of analysis, namely the barriers to investing, will take you close to the conclusions of your assessment.

1.5.2. Barriers to and opportunities for providing affordable, relevant and proportionate financing

Although social investment markets have evolved at varying speeds, there are some common barriers and challenges that investors have reported regardless of geography. It is important to be aware of these, as you may be the actor that can do something about them. Some of the most important barriers can be summarised as follows.

- Social enterprises are **perceived by investors as high risk**. They are often small, lack classic business planning and management skills, and do not have a solid asset base to back the investment. Lack of collateral could be overcome by strong cash flows from a good business model, but start-up enterprises often cannot produce convincing financial projections due to a lack of capacity or prior experience. However, the risk is often only a perceived high risk due to the investors' limited understanding of social enterprises or the information asymmetries in the market.
- Social enterprises often need smaller amounts of funding than would be efficient for classical investors to provide, which leads to **high per-deal transaction costs**. Sourcing, due diligence and assistance with business planning costs all add up and are often higher when dealing with smaller start-up organisations than with larger, better-established ones.
- **Social impact measurement** is challenging for both investors and investees. While investees often lack the capacity to implement outcome and impact measurement and reporting systems, the challenge on the investor's side

lies in being confronted with anecdotal evidence or inconsistent data – or missing quantifiable information altogether. Investors may also lack the skills or experience to interpret the impact data and its relevance to their strategy. A lack of globally utilised impact measurement standards – except for a few initiatives, such as Impact Reporting and Investment Standards (IRIS) ⁽³⁴⁾ – makes it difficult for investors to benchmark their investment against others, which in turn makes it hard to understand the full value of, and therefore to put a price on, social impact.

- **Market size** in many countries can prevent social enterprises from even appearing on investors' radars. Small deal sizes and the small number of deals make the market unattractive to investors who wish to place significant amounts of funding. The emergence of private equity 'megafunds' – very large pools of money – may, however, create a contradictory effect of crowding out small deals even when they offer significant impact potential.
- **Markets are fragile**. The price, ability to pay and social value generated are often out of sync, which makes social enterprise business models unstable and unsustainable.

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IRIS is the catalogue of generally accepted performance metrics (social, financial and environmental), managed by GIIN. Source: Global Impact Investing Network (2019).

TIPS: IMPORTANT QUESTIONS TO ASK DURING THE ASSESSMENT PROCESS

Demand side:

- What are the key attributes of a successful social enterprise in the market? Who is a specific example? Are there case studies/ lessons learnt from failure?
- What are the support needs of social enterprises? Which are not met, and why? What are the main obstacles to social enterprises becoming attractive investments?
- What is the social impact of social enterprises, and how is it communicated?
- Where are the key opportunities for growth for social enterprises and their financing models? Is there a showstopper for further development and growth?

Supply side:

- What motivates the current finance providers? Where do they sit on the investment spectrum?
- Which players dominate the supply side, if any? What is the balance of public, philanthropic and private investment finance? Do dominant players distort the current or potential market?
- Why aren't other funders or investors joining in? What are the key barriers for them?
- What forms of collaboration, if any, exist among different stakeholders in the social finance market?
- What are the key barriers to investment, and are there any incentives to invest?
- What is the supply of support organisations?
- Is there capacity for follow-on investment and/or a secondary market, leading to more liquidity and ability to exit an investment?

1.5.3. Methods of assessment

In most European countries, there is already a social enterprise and social finance market, however nascent or young, and there is a growing body of research and literature that can help you jumpstart your engagement with the market. In very few cases will you have to go back to start your assessment from scratch. A useful starting point can be the first comparative, Europe-wide study, which was published by the European Commission: *A Map of Social Enterprises and Their Ecosystem in Europe* ⁽³⁵⁾. It outlines the main aspects of social enterprises in the EU Member States and Switzerland, and offers an overview of social enterprise ecosystems across these countries.

During your market assessment, you can follow a standard market research methodology, starting with secondary sources – namely, studies, reports, articles, websites and databases that have been produced by others. Secondary sources can be very useful for two reasons: 1) they can help increase your general understanding and identify unanswered questions, and 2) they will help you to create a list of actors and stakeholders active in the space who you might wish to contact in the future. Conferences, fairs and major events could also be a good place to meet the major players and learn about trending discussions in the field.

Once you have a general overview, you can use primary sources to dig deeper. Primary sources are typically people and organisations whose opinions and experiences can be crucial for clarifying, fine-tuning or supplementing the information collected from secondary sources. Beware, however, that many of the people connected with social enterprises or social investment have strong, often polarising views, which you may have to weight or discount in your thought process. Remember, too, that the market is very young, with no actuarially significant data.

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European Commission (2015a).

TIPS: WHO TO TALK TO FOR YOUR ASSESSMENT

1. Focus on key actors and opinion leaders. These can be:
 - a) leaders of coalitions, alliance and umbrella organisations, for example, the social enterprise coalition in the country you plan to operate in or the director of the Donors Forum (the membership organisation of private foundations);
 - b) outstanding and vocal individuals, i.e. successful social enterprises on the demand side and major investors on the supply side;
 - c) researchers and academics who have been studying the field;
2. Identify representatives of beneficiaries in order to understand the ultimate impact of providing finance to social enterprises.
3. Include organisations with new or unusual approaches to the market; they may still be small, but they could become the next generation of investees/investors.
4. Identify relevant public sector officials who are willing to share the regulator's and policymaker's perspective.
5. Don't forget the intermediary and support organisations.

If you are unable to identify such leading actors, it might indicate a gap in the market – or that you are looking in the wrong place.

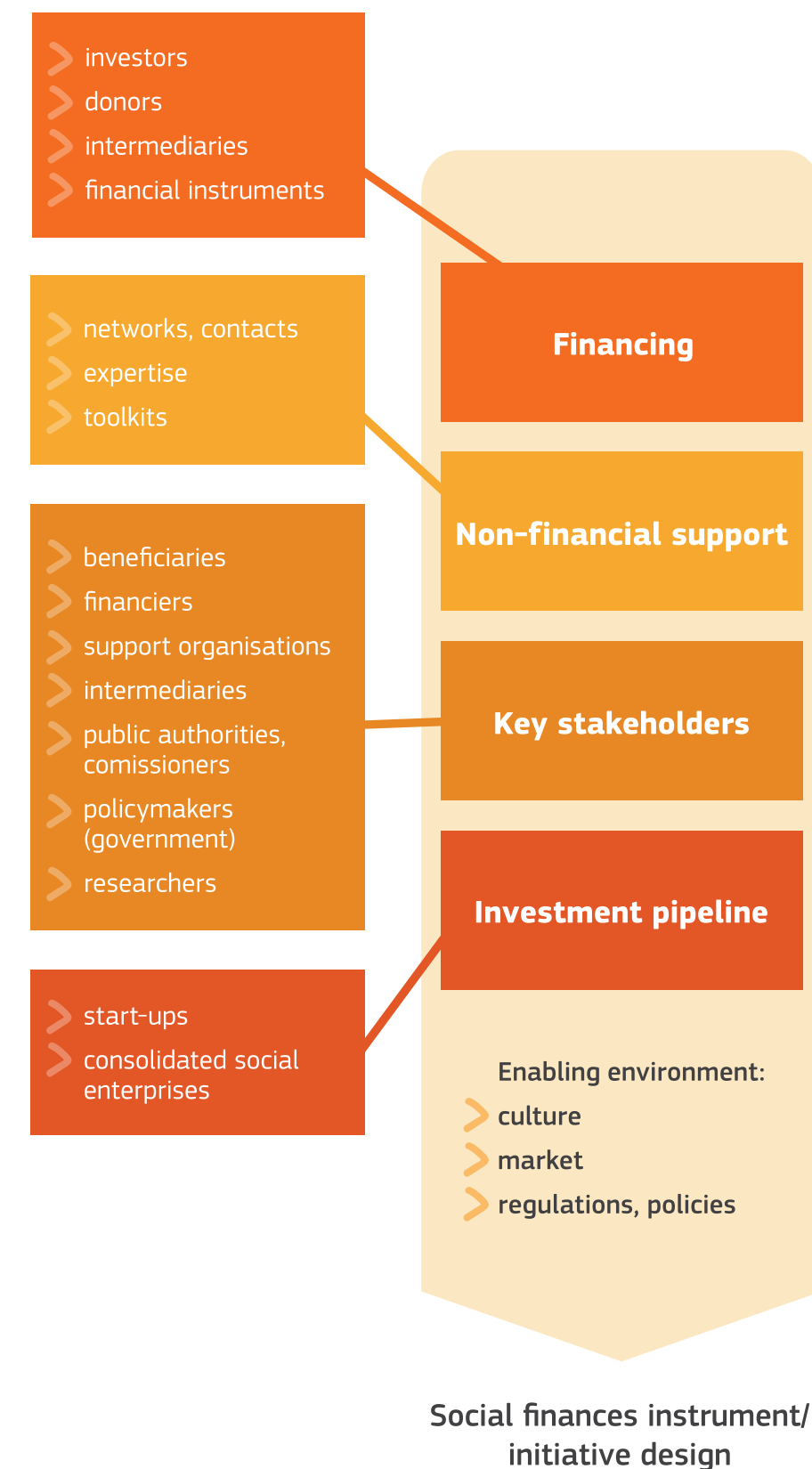
Primary sources can be explored in one-on-one interviews, focus groups or written surveys, depending on your resources and on the number and availability of people you wish to interview/survey. In very few cases will you have the time and resources to interview a large number of people and produce statistically significant reports, so it is crucial that you select your primary sources carefully.

Exercises 2 and 3 at the end of Chapter 1 can help you compile the information you have gathered about financing and non-financial support in your target market.

1.5.4. Conclusion of the assessment

Once the research phase has been completed and the information compiled in all key areas as shown in Figure 7, you may start to get a feel for the social finance market in your community. You may find that the ingredients of the recipe don't yet come together or that key ingredients are still missing. The market could still be viable with only some of the ingredients in place, and it is for you to decide based on your assessment whether you want to be a part of it and what initiative or finance instrument to launch. The example of Social Investment Scotland shows how it was able to build a series of programmes, including awareness raising, capacity building and eventually a fund, upon the findings of their market assessment. Information and data captured during and since that research was useful in stakeholder engagement, especially with local and central government.

Figure 7. Key areas in the assessment of the social finance market



EXAMPLE: MARKET ASSESSMENT CONDUCTED BY SOCIAL INVESTMENT SCOTLAND

Social Investment Scotland is a charity and social enterprise that provides loans to charities, social enterprises and community groups in Scotland. In developing a pilot project for the EU funding programme to address the supply and demand sides of the social enterprise finance market, its main objectives were: 'to identify and define the marketplace; raise awareness of social investment; and increase knowledge, skills and attitude with regards to taking on social investment'. It also planned to provide a hub of shared learning and best practice and to serve as a conduit for business planning support.

Market assessment was a crucial first step in the project because further elements of the programme would be built on this foundation. Social Investment Scotland therefore commissioned research to break down the third sector in Scotland by geography and sector, as well as to identify intermediaries providing services to 'third sector trading organisations'. The basis of the analysis was a recent survey conducted by the Big Lottery Fund (UK), which had identified

about 3 500 social enterprise organisations in Scotland. In addition to this, the Social Investment Scotland research looked into perceptions of the barriers and opportunities to social investment from the viewpoint of the intermediary, interviewing 40 such organisations in Scotland.

During the research and the capacity-building and promotion programme that followed, Social Investment Scotland was able to disseminate information about social investment directly, as well as use key intermediaries as conduits to spread the message about social finance opportunities. Social Investment Scotland has also provided the databases created from this survey to key bodies such as Highlands and Islands Enterprise and the Scottish Government in order for them to better understand the make-up of the sector ⁽³⁶⁾. In continuation, Social Investment Scotland has recently launched 'SIS Ventures', a new arm of the business raising investment from private individuals to support both social enterprises and other innovative forms of mission-led business.

The overall conclusion of the first assessment may be that:

- **There is the space and a need for your initiative.**
➔➔ Move to Chapter 2: Create your vision and design your initiative.
- **You need to explore further.**
⬅⬅ Back to Chapter 1: You need to do more market assessment.
- **Your initiative is not necessary or feasible.**
Abandon the idea or monitor and re-examine the situation in a few years' time.

36 Based on the final project report submitted by Social Investment Scotland; see Social Investment Scotland (2019).

Your summary questions for Chapter 1:

- What is the overarching vision of the market you are contemplating?
- What are your top three questions for the assessment of the social investment market?
- If you are an investor, where do you place yourself on the investment spectrum? How does this sit with your values? Are you a social investor?
- If you are an intermediary, where do you see your niche and value added in the market?
- Which stakeholders do you think you need to collaborate with more closely?
- Do you agree that social investing is about attitude not asset classes?



Exercise 2. Availability of financial support/investment

This simple ‘staircase chart’ may help you to summarise the demand- and supply-side findings of your market assessment. Fill in the boxes with what financing instruments are available in your market and what sources could provide them to help you identify the existing gaps.

	Blueprint	Validate	Prepare to scale	Scaling
Typical capital need	EUR 0-50 thousand	Up to EUR 100 thousand	EUR 100-500 thousand	Over EUR-500 thousand
Over EUR 1 million				
EUR 500 thousand- 1 million				
EUR 100-500 thousand				
EUR 50-100 thousand				
EUR 0-50 thousand				

< Maturity of social enterprise >

Exercise 3. Availability of non-financial support

Your research will have identified the key stakeholders and their offer, including non-financial support. It may be useful to chart this non-financial support in order to find your niche. This plotting can be done along different dimensions; the most important ones should have become apparent in your market assessment. This example shows the availability of support along the support–social enterprise development stage axis, corresponding to the financial support chart.

	Blueprint	Validate	Prepare to scale	Scaling
Technical skills				
Business planning				
Mentoring				
Coaching				
Peer learning				
Training				
Investor advice				
Matchmaking				
Networks				
Space				
Other				

< Maturity of social enterprise >

Chapter 2

Create a vision, define your goals and define value added

The market and your role in it

- > 2.1. Approaches to social investment 62
- > 2.2. Mapping social investment onto your appetite:
Advantages, disadvantages and risks 64
 - 2.2.1. Risk appetite 66
- > 2.3. Non-financial support offered 68
- > 2.4. Partnerships and collaboration:
Their role in your vision 69

Learning objectives

On completion of this chapter, you should be able to:

- articulate your vision, goals and motivation for getting into social investment;
- assess the different types of risks and map them onto your appetite;
- assess the need and uses of partnerships and collaboration in social investment;
- assess the added value you bring or will create.

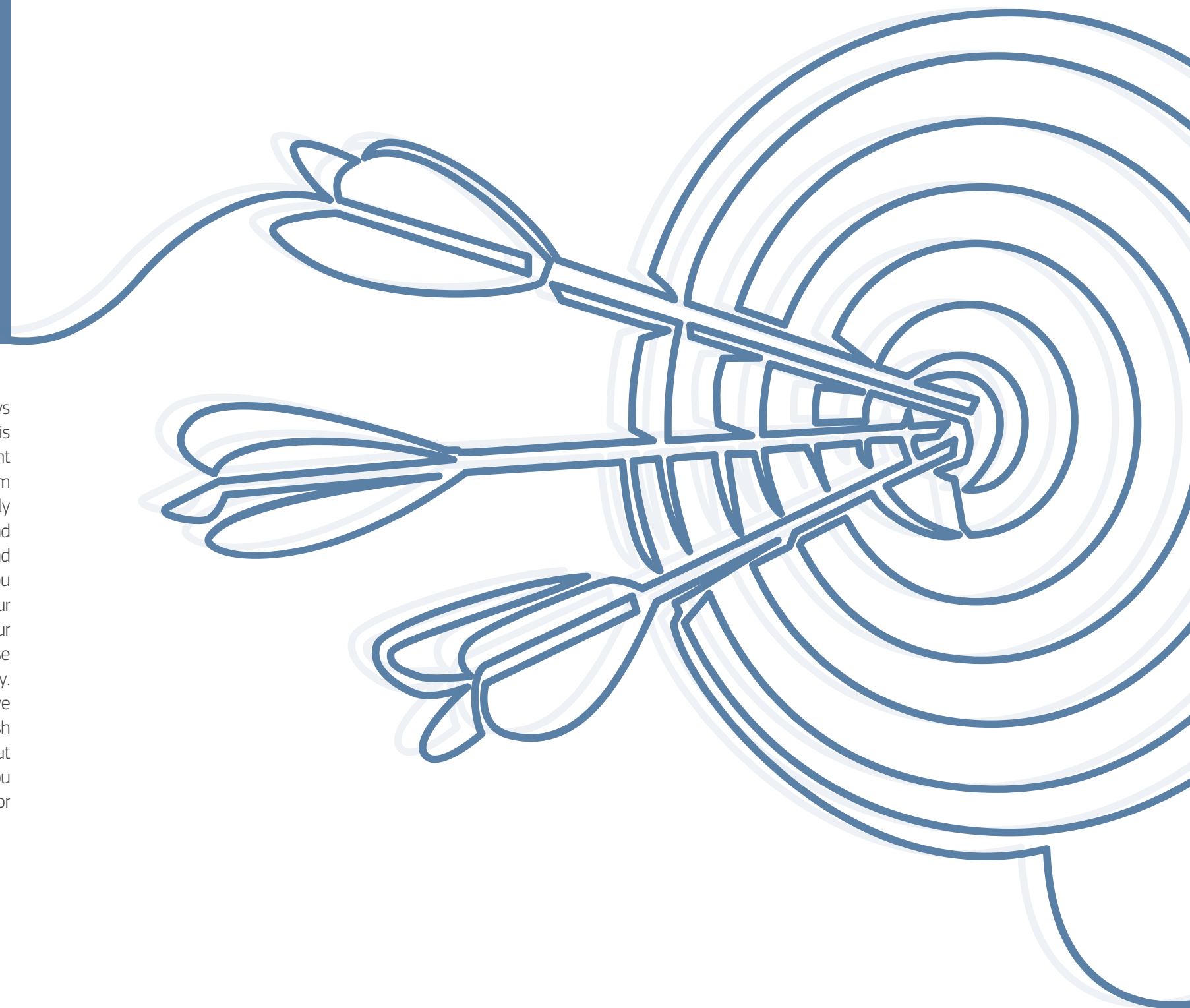
At this point, you should ideally have the following in place:

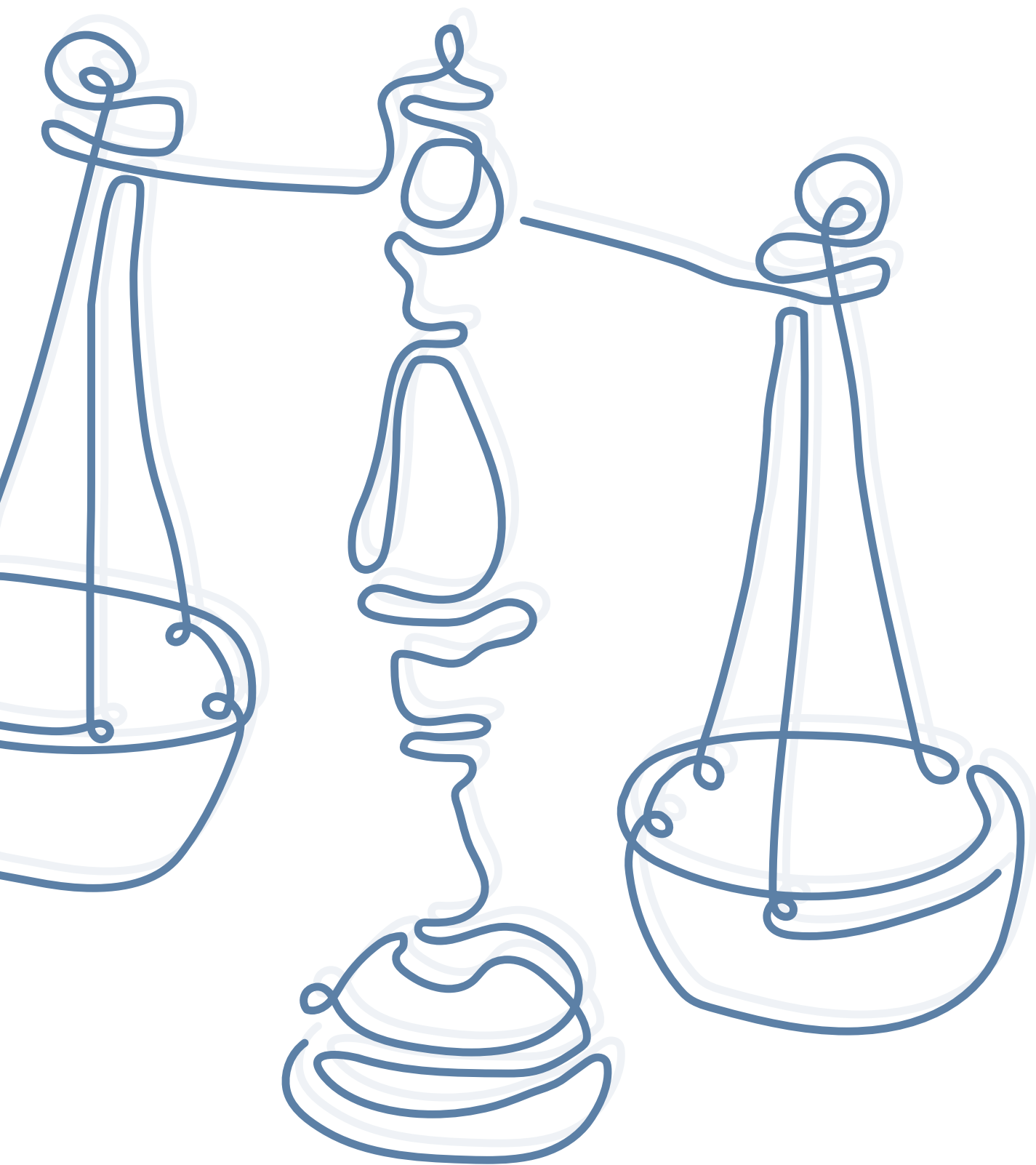
- an assessment of the financing needs of social enterprises (demand);
- an assessment of the key players and elements of your social finance market;
- an assessment of available financing options (supply);
- an overview of the legal and regulatory environment and the financial and entrepreneurial culture.

You may be an existing or future social investor. Your financial regulator may classify you as a sophisticated or professional investor. You may be a mainstream investor. Or, indeed, you may know little about investing, the third sector or social enterprises. You may also be a social enterprise, support organisation or network keen to see a particular need addressed or initiative get off the ground. Whoever you are, you need to know what sort of market you would like to contribute to or what sort of instrument you'd like to create, and what your value added might be.

You may feel that there is too much information and there are too many choices, which only serve to paralyse your actions. Perhaps you feel that you need a guide to help you figure out your goals and how you might achieve them.

The truth is that even the best guides don't always agree with each other, and nor should they: there is no one-size-fits-all approach. The social investment market is much less mature than the mainstream investment market, and the data is actuarially insignificant. The key is to develop your vision and understand what is going to work best for you and the community or cause you seek to help. While you have to see what makes sense to you, what your goals are and try to figure out what's right for your situation, you should also continually check the sense of your vision with your social enterprise community. The simple solution can often be more effective than the complex approach. But while you may wish to block out the noise of the marketplace and put a simple and easy-to-follow strategy in place, you must equally ensure that you are not disrupting or displacing other initiatives.





Take a look at the continuum referenced in this guide (see Figure 4) and Section 2.1. that follows here. Then ask yourself the questions below.

- ***Are you new to investing, or have you previously invested just for financial return?***
- ***Are you an individual investor, a foundation or other charitable body, a faith organisation, a fund?***
- ***Do you have a charitable mission?***
- ***Are there any restrictions, be they constitutional or in law, that affect whether or how you can invest?***
- ***If you are an individual, what are the values that guide you or that you live by?***
- ***What type of investor do you want to be? A pioneer or one of the crowd? Impact-first or finance-first ⁽³⁷⁾?***
- ***What is your risk appetite?*** Consider this along a continuum ranging from the possibility of losing all of the money you have invested, to an erosion but not total loss of your capital, to preservation of your capital after inflation and, finally, to an increase in your capital through dividend, interest income or capital gain.
- ***What are your return criteria?***
- ***What will you bring to this investment? Just money, or can you have any other input?***
- ***What is the opportunity cost to you of social investing? What else could you do with the money?***

The thought processes that these questions encourage should help you draw up a checklist that indicates whether you are a financial investor or a support organisation, or whether you are better off offering grants or gift money. Table 5 in Section 2.2. summarises the advantages, disadvantages and risks of social investment for investors and investees.

If you are a charitable or other mission-focused entity, or a person with a strong set of values, social investment can promote greater alignment between your mission/values and your investment portfolio, and it offers the potential to build your social impact through the recycling of funds as investments mature or loans repay. The processes and requirements of social investment can lead to more accountable and more sustainable investees, while also freeing up some of your grant pot for other needs. Charity and foundation trustees have certain legal responsibilities, often referred to as fiduciary duties, which can limit where they can invest the charity's funds. Family offices and other financial advisors can be overly protective in how trustees apply their funds, so it is advisable to consult your legal rather than your financial advisor. Another recommendation is to read Stephen Viederman ⁽³⁸⁾. Viederman sees a chasm between mission, grantmaking and investment, and an absence of the logic of synergy.

Though grantmaking can be complementary to social investing, they are not the same. Social investing is often a steep learning curve and may require different skills and resources. Its markets as we know them today are immature and developing all the time. Throughout Europe, even in more established markets, there is an unclear, or at best untested, legal and regulatory environment. This is at least in part because regulators are often playing catch-up in such new markets. The growth of crowdfunding, for example, caught regulators and policymakers off guard. This means that you are likely to have to deal with varying levels of uncertainty. If you are an endowed foundation or another body where the core capital has to be preserved to meet future obligations, you may require greater certainty of financial return. Some of the largest risks are that the potential returns – social, emotional and financial – are not delivered.

³⁷ A pioneer or market builder is driven by a belief in the importance of social investment as a source of alternative capital for third sector organisations and society as a whole and the potential to create social innovation. The pioneering investor is willing to take on more early-stage risk to encourage the market to grow and attract new participants. These investors are essential to the development of new markets in Europe. As is implied, an impact-first investor is one who maximises the social impact of the portfolio.

³⁸ Stephen Viederman is the former president of the Jessie Smith Noyes Foundation. Source: Viederman (2011).

2.1. Approaches to social investment

Depending on your motivation, you may approach social investing from two different perspectives or from a point on the line between them. The checklist in Table 4 can help highlight the difference.

Finance-first investors prioritise making a financial return and at least preserving capital after inflation on an investment: social investment is treated no differently. As a result, they may only be interested in investments that offer a rate of return close to or competitive with the mainstream and/or in secured investments (typically bricks and mortar) where there is strong asset backing for their investment. As indicated earlier in this guide, a finance-first approach may be a good first step for a first-time investor or for a person or entity looking to diversify their portfolio beyond the mainstream. Being a finance-first investor need not mean sacrificing social impact, but it may narrow your choices. If you are new to social investing,

beware of the hype around rates of return and don't allow your expectations to be raised too high.

At the other end of the spectrum, **impact-first** investors prioritise investments that generate a high social impact. Sometimes the nature of the impact may in itself generate the potential for higher financial returns, especially if there is compensation through the tax system. However, more often than not, impact-first investors are willing to accept lower or even no financial return if the social impact created is high enough, while some may also be prepared to accept capital erosion or a subordinate role to enable more financially attractive returns to be offered to other (finance-first) investors.

Table 4. Checklist: Why do I want to become a social investor?

Note: This is not an exhaustive list. Your options will be shaped, inter alia, by your values and your investment and return criteria.

Question	Possible answers	Options for action
What are my objectives?	a) I want to help a specific organisation in my community.	Invest directly, provide a guarantee or invest through an existing fund.
	b) I want to be part of systemic change in the use of finance.	Invest in a values-based bank.
	c) I want to help in a particular sector or sectors.	Choose to invest in a fund that helps in this area.
	d) I want to bring like-minded people together for a joint initiative.	Form a working group or a subgroup of an existing enterprise network.

What financial and social returns do I require?	a) I am a finance-first investor.	Focus on enterprises with proven cash flows and established track records. Invest directly or through an intermediary that also has a track record of performance and low bad debts.
	b) I am an impact-first investor.	Invest in earlier-stage or growth enterprises or those with few assets and/or where you can identify the impact your investment will achieve.
	c) I am in-between the extremes on the investment spectrum.	Choose investments and intermediaries that lie between the two extremes.
What risks am I prepared to take? (See also Section 2.4.)	a) I am prepared to lose all or some of my money.	Invest in high-risk social enterprises, start-ups or those with unproven revenue generation.
	b) I want to preserve my money.	Require security to cover all or part of the risk and/or move down the risk curve.
	c) I need some financial return.	Invest in lower-risk enterprises, possibly through a proven intermediary.
	d) I want to maximise my financial return.	Invest through a mainstream impact-investing fund.
Can I do this alone or would I be better co-investing? (See also Section 2.5.)	a) I am a small-scale investor and understand the risks involved.	Invest alone.
	b) I am new to social investing or the market sector I want to invest in, or do not feel confident in my own abilities to assess risk.	Invest through an intermediary.
	c) My money is not enough for the need I want to cover.	Look for a co-investor at the individual deal level or to invest in a joint fund.
How long can I devote to the investment?	a) I have all the time it takes.	Your options are wide open.
	b) I have about 15 years.	You can start setting up an initiative from scratch, but be prepared to pass it on if more time is required ⁽³⁹⁾ .
	c) My time is limited, or I don't know if I may need to access the money quickly.	Invest through an established intermediary and understand their liquidity policy. Many social investments cannot be redeemed quickly or ahead of scheduled maturity.

39 A real-life example is the experience of Investors in Society/Charity Bank. After 18 months of market research, it took another 1.5 years to secure funding to launch a pilot fund and then another 7 years to get to scale through the creation of a regulated bank. That is a total of 10 years, plus another 8 to become profitable year-on-year.

Due to your goals or where you think you can add value, you may decide that you want to be somewhere along the finance- or impact-first continuum rather than at one end. In such instances, you are making mixed motive or blended return social investments (see Figure 4). Similar to grantmaking organisations that focus on cutting-edge research or innovative projects, some social investors target the ‘white spaces’, i.e. sectors or areas where there is a need, but where nobody else has invested before. In those cases, the objective may

be very general, such as ‘to increase the availability of sustainable funding’, but it may also be very concrete, such as ‘eradicating a certain disease’. It is important to turn your vision into concrete objectives, so that you will be able to chart the best road to achieving them and measure your progress on the way. Quantifiable objectives may be hard to come up with at this point, but information from the market assessment, as well as your own resource availability, should help you narrow down your options.

2.2. Mapping social investment onto your appetite: Advantages, disadvantages and risks

What are some key considerations when creating your vision and deciding whether you want to be a social investor at all?

Depending on the strategy you have adopted and your circumstances, you will find some of the advantages will be more or less compelling and some of the disadvantages more or less of a constraint. If you are interested in financing high social impact and have an appetite for risk, you may be less concerned about preserving your capital. Think about your values or mission and what you are trying to achieve, as well as the money you have available. **Are you focusing on just one organisation’s work, the regeneration of a community, supporting a particular environmental development or finding a cure for an intractable disease? Or, do you just want a percentage of your overall investment portfolio, including holdings of cash, to be invested socially? Do you want to allocate, say, 10 % of your annual income or profits to social investment?**

In France, for example, there are a number of instruments that give you the option to split your investment between the social sector and mainstream investment ⁽⁴⁰⁾.

Do you want to be a proactive, reactive and/or collaborative funder? A proactive investor will seek out investment opportunities in line with their values or objectives, as well as react to opportunities. An investor who decides on a reactive strategy will wait for suitable opportunities to be introduced, often by known and trusted contacts or intermediaries. This may bring the benefit of existing due diligence that the investor can draw upon. It can suit investors with limited resources and broad social investment objectives. The relatively small number of active participants in the market leads to collaboration among investors. A collaborative approach can spread costs across investors while also potentially reducing risk, especially where co-investors may be more experienced (see more about co-investment in Section 2.4.).

Table 5. Advantages, disadvantages and risks relating to social investment for investors and investees
Source: Rotheroe et al. (2013)

	Investors	Investees
Advantages of social investment	• Leads to closer alignment between investment portfolio and values/mission • Can generate financial return • Has the potential to increase social, environmental and/or cultural impact, as well as economic benefit • Increases efficiency by recycling funds • Can free up scarce grant or gift money • Increases accountability for investees	• Allows faster growth or investment in assets • Improves access to finance, can lever in additional sums • Conserves unrestricted cash needed elsewhere • Is a vote of confidence in the organisation’s aims • Potentially increases sustainability • Provides new financial discipline • Opens the organisation up to a new audience
Disadvantages of social investment	• Can entail a steep learning curve • Is likely to require additional resources and skills • Has a short-track record with no actuarial base • Remains a young market • May not provide the right amount of money at the right time or at the right price	• May need a lot of work for the organisation to become investment ready • May require culture change • May divert resources and time due to ongoing scrutiny • Requires repayment
Risks of social investment	• Financial return may be sub-market or capital is eroded or lost • Limited liquidity in secondary or follow-on markets • Social impact is not delivered • Social impact is hard to measure/quantify • Reputational risk, especially where things go wrong • Legal and regulatory risks	• Unable to repay investors • Social impact is not delivered • Firefighting impacts other activities • May cannibalise existing funding streams • May cause mission drift • Could cause closure

40 90/10 solidarity investment funds permit up to 10 % of the fund to be invested in unlisted, solidarity-designated organisations. The funds are company-based employee long-term savings schemes. The French Fonds d’investissement de proximité (FIPs) permit up to 70 % to be invested in SMEs, including social enterprises, within defined local areas. Source: Dupuy and Lagendorff (2014).

2.2.1. Risk appetite

There are a number of risks involved in any investment: financial, liquidity, operational, political and reputational. In social investment, there is also social impact risk and emotional risk. As neither social nor financial returns in a social investment are yet well understood, we would add an extra risk: knowledge or information risk. This additional risk increases the level of risk for the market as a whole. Together, these make up the investment risk.

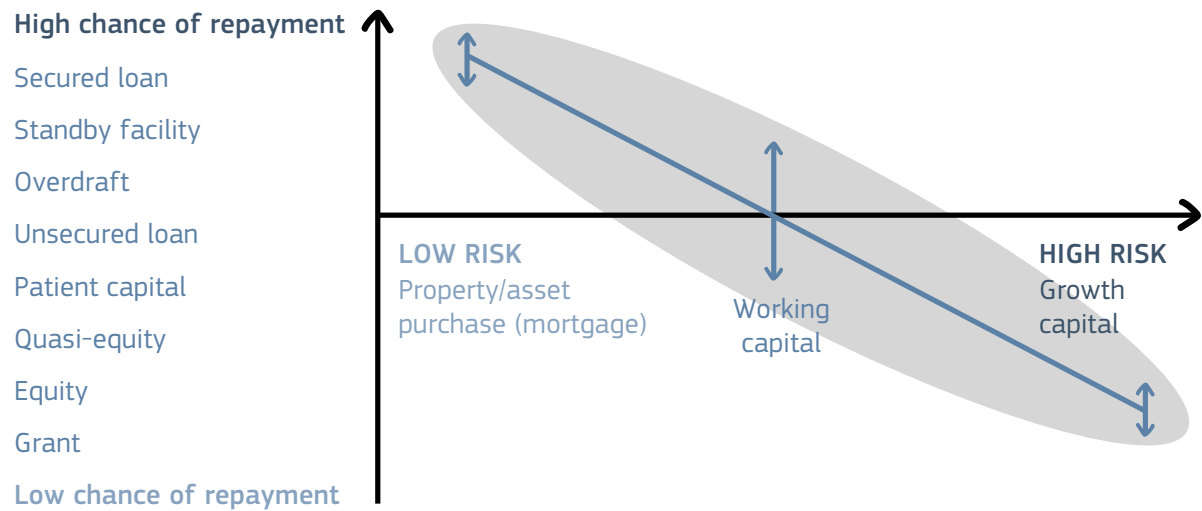
Financial risk is determined by the degree of certainty of monetary returns. As with mainstream investing, the level of financial risk varies across types of intervention. Given the lack of actuarial data about the sector or the performance of social enterprises, the pricing of financial risk within a social enterprise

transaction has often been based on what the borrower or investee is perceived to be able to afford, rather than pricing for risk per se.

Figure 8 illustrates the relationship between the chance of repayment and risk across various financial instruments. Funding with a high chance of repayment represents the lowest financial risk. So, secured loans and standby facilities with the most predictable return and greatest asset cover are the lowest risk. The highest risk or least predictable return comes from equity, quasi-equity and grants that do not expect to be repaid. An investment in a start-up enterprise or a new instrument based on Payment by Results are higher risk.

Figure 8. Matching appropriate funding mechanisms with funding needs

Source: © CAF Venturesome (2010)



Some pioneer investors, including many who entered the market at an early stage, have been prepared to accept high levels of risk to support the market's growth. However, some who may have different motivations or pressures can find that the financial

risks are not adequately compensated for by the financial return. These investors may opt for lower-risk instruments until such time as the risks are more clearly understood and/or there is greater liquidity in the market.

A further dimension can be added to financial risk if you operate across borders or have security in a different currency to your own. For example, at various times, borrowers in countries such as the UK and Hungary took loans in Swiss Francs, only to see the exchange rate move heavily against them, requiring a rescheduling and in certain cases, a formal amnesty on payments. Such risks can be compounded by differing legislative rules between countries.

Liquidity risk is the risk that you will not be able to exit your investment and that a short-term investment will become a long-term or even permanent commitment. Even though bonds are among the range of instruments now available within social investment, there has been little if any development of secondary markets, listings or other mechanisms through which investors can reduce or exit their investments with any degree of certainty. As a result, there has been no refinancing of SIBs and hardly any of other social finance instruments. While refinancing may become possible with time, especially if social stock exchanges become more akin to commercial exchanges rather than simply lists, investors should assume for now that they will hold their investments at least until nominal maturity. Another liquidity risk arises for the borrower or investee and relates to their ability to manage higher or lower financial costs in more volatile markets.

Operational risk arises from a combination of governance and management structures and skills. Has the enterprise got the ability to manage the investment and its impact upon the organisation without destabilising it or heightening the risk? Can it do what it says it can? Operational risk can also arise from changes in the external environment and the extent to which the enterprise understands what risks may impact it, what risk mitigation strategies it has adopted, who owns them and how frequently they are reviewed.

Risk forecasting and management are evolving practices ⁽⁴¹⁾. Whether you are investing in an intermediary, support organisation or a front-line social enterprise, ask if they have a risk map or risk management framework and how risk ownership is apportioned between the board and the executive (assuming the enterprise has such a differentiation).

Social impact risk is the risk of not achieving the anticipated social impact from an investment. The relationship between social impact risk and return is poorly understood. It will not necessarily be the case that a higher social return means a higher level of risk. Social return can also be impacted by **political risk**. For example, the social return from the first SIB in the UK was based upon a reduction in the rate of re-offending by short-term prisoners; however, the government of the day changed the rules mid-programme, effectively ending the bond prematurely. Such changes have consequences for the period of time you expect to have the money tied up and the return you may achieve. In the worst-case scenario, there may be no return at all, which will impact investor confidence in future deals. To many, social investment – especially around Payment by Results – is controversial.

Any perceived failure of an instrument can bring **reputational risk** for the investor and the social enterprise. As was witnessed in 2017-2018 amongst some large NGOs operating in the international aid and healthcare sectors, reputational risk can also arise from losing sight of one's values, inappropriate behaviour or insensitivity to social justice issues both on the part of the organisations themselves and people associated with them, such as employees ⁽⁴²⁾. If reputational issues impact an organisation's ability to raise money or sell its products, the risk rapidly becomes a financial one.

41 Visualcapitalist.com (n.d.).

42 Early reports of child sexual exploitation by aid workers and peacekeepers can be found in No One to Turn To (www.alnap.org).

Emotional risk arises because, at its root, social investment is values led and often works in highly emotional circumstances addressing issues of social injustice, marginalisation and exclusion. On one hand, emotions can lead you to make decisions from the heart rather than the head, but there is also the risk that the social impact will vary from what you had expected. You may also get too close to an enterprise because of ‘what they do’ and so postpone difficult decisions. Emotion can also play a role when you have a number of seemingly impactful proposals to choose from, but only limited resources. How do you choose? To mitigate emotional risk, it is important to challenge yourself as to why you are lending to/guaranteeing/investing in your portfolio enterprises.

The social investment market is young, poorly researched and lacking an actuarial base in terms of its performance data and experience. There is therefore a

knowledge or information risk in that decisions are made without complete information. Hopefully this will diminish over time, but it is still essential to perform due diligence on your source material. Is the need truly what it seems to be? Information asymmetries can be reduced as collective data sharing platforms develop. In 2018, the Principles for Responsible Investment (United Nations, UN) launched the Impact Investing Market Map ⁽⁴³⁾ to bring greater clarity to the process of identifying mainstream impact investing companies and thematic investments in the context of the UN Sustainable Development Goals (SDGs) ⁽⁴⁴⁾ and 10 themes that were developed based on those goals.

The weighting of these risks may determine the amount of funding or the percentage of your overall portfolio that you will want to allocate to social investment. One way to manage some of these risks is to work with partners.

2.3. Non-financial support offered

One outcome you will want to see is the creation of more sustainable and accountable enterprises that are better positioned to tackle societal issues. So, if you are an investor, you may be motivated by your professional background or business or life experience to engage with non-financial support too. What do you bring in addition to money? Non-financial

support may take various forms: from becoming a director (preferably non-executive), a counsellor or advisor on specific issues (e.g. a new product or service development) or a mentor, to opening up your networks to the organisation and introducing them to areas of excellence or supply chain contacts.

2.4. Partnerships and collaboration: Their role in your vision

It may be very ambitious for you to achieve your vision and goals on your own, especially if you are planning to operate in an underdeveloped social investment market or if you are launching an initiative that requires the contribution of other players. You may be in need of significantly more or specialised resources, or perhaps key contacts and experience that potential partners will have. Or you may simply need a critical mass to create momentum and raise more awareness of and funding for social enterprise.

Investors may seek co-investors to increase the available capital and share the risk, or to partner with support organisations that can provide non-financial support for their investees. Depending on what your vision and goals are, you may simply work with others as service providers on an occasional basis. More interesting, though, can be long-term cooperation with potential partners. Such partners should be part of the vision from the start, so that you will find the optimum set-up once it comes to accommodating them within your structure. Partners with a shared vision can be a tremendous asset, but you need to be sure about the alignment of values and objectives.

If you are a non-financial investor, i.e. a support organisation or intermediary, the question you may be asking yourself is:

What kind of investor you would like to work with and to whose investees you would like to offer your non-financial support? Or, who do you want to bring on board to fund your investment-ready social enterprises?

There is a detailed discussion in Chapters 3 and 4 about the advantages and disadvantages of including partners or co-investors in your investment or intervention strategy, and the example of TISE shows how these can play out in practice. Partnerships and collaboration are also a feature of scaling strategies, which we discuss in Chapter 7.

Your market assessment will have provided a lot of useful information and given you an overall picture of your targeted social investment market.

How close or how far is it from your vision? Is there a reasonable distance that you are prepared to travel from current to the ideal? Are your skills and resources a good match to fill the gaps you have identified and meet those needs? If they are not, should you be entering this market at all? If they are, can you turn your vision into goals and objectives for yourself and your partners?

Objectives should ideally be S.M.A.R.T ⁽⁴⁵⁾ (specific, measurable, attainable, relevant and time-bound), so that you can come up with a roadmap for how to reach them and be able to measure from time to time whether you are getting there. Your objectives may apply to the process of building a social investment market overall, or to solving a specific social problem by way of supporting social investment solutions. More discussion on the role and contribution of intermediaries and market facilitators will follow in Chapter 4.

43 Principles for Responsible Investment (n.d.).
44 United Nations (n.d.a).

45 Doran (1981).

EXAMPLE: TISE ENVISAGE A SOCIAL LOAN FUND FOR CENTRAL EUROPE

In 2014-2016, social and economic investment company Towarzystwo Inwestycji Społeczno-Ekonomicznych (TISE) implemented a regional project with the aim of establishing an impact fund to provide capital, quasi-capital and loans for social enterprises in a number of Central European countries. Market assessment made the TISE team confident about a reasonable pipeline of borrowers and also revealed that in the target countries there were support organisations and/or intermediaries that had intimate knowledge of the field and of individual social enterprises. The team had been building the capacity of these businesses and had tried to raise financing for them too, with limited success. The TISE offer would have therefore filled a gap, provided that demand and supply could be matched.

Based in Poland, TISE had a strong track record in lending to charities and social enterprises in its home country, but it needed similar market intelligence and capacity in the other geographies in order to make successful deals. Partnering with local intermediaries and support providers was therefore a key part of TISE's vision – not only to supplement the small core team's capacity, but also to select the best possible investment targets for the portfolio and to build the capacity of the local

intermediary and borrowing organisations. Many of these potential borrowers would have been using external financing for the first time, so that would have been as much a learning experience as a new financing strategy. TISE was confident that it could engage local support organisations and intermediaries in the long run in various stages of the process, starting from sourcing investment deals, through to providing business support and monitoring performance. TISE would offer financial incentives to these collaborating partners in the form of proportionate fees in exchange for their services and intervention ⁽⁴⁶⁾.

Partnerships and collaboration were fundamental elements of TISE's vision and goals in this initiative. And they were not the reason the impact fund failed to materialise in the end. Even though the fund's scope would have been regional, TISE ultimately found it challenging to convince potential fund investors that there was a reliable investment pipeline, which was necessary to provide fund sustainability and the expected returns. Lack of investable social enterprises continues to be a challenge in Central Europe, but the lessons learnt in this case are just as much about lack of social investors and the unrealistic expectations of the few that were present.

46

Based on the final project report submitted by TISE. Source: Towarzystwo Inwestycji Społeczno-Ekonomicznych (2019).

Your summary questions for Chapter 2:

- Why do you want to engage in the social investment market?
- What is your vision and what are your objectives?
- What is your value added?
- How much risk are you prepared to take?
- What resources are available to you?
- Who do you need/want to cooperate with?
- How long are you prepared to give your investment?



Chapter 3

Build an investment strategy

Mixing the ingredients that mitigate gaps and risks

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Learning objectives

On completion of this chapter, you should be able to:

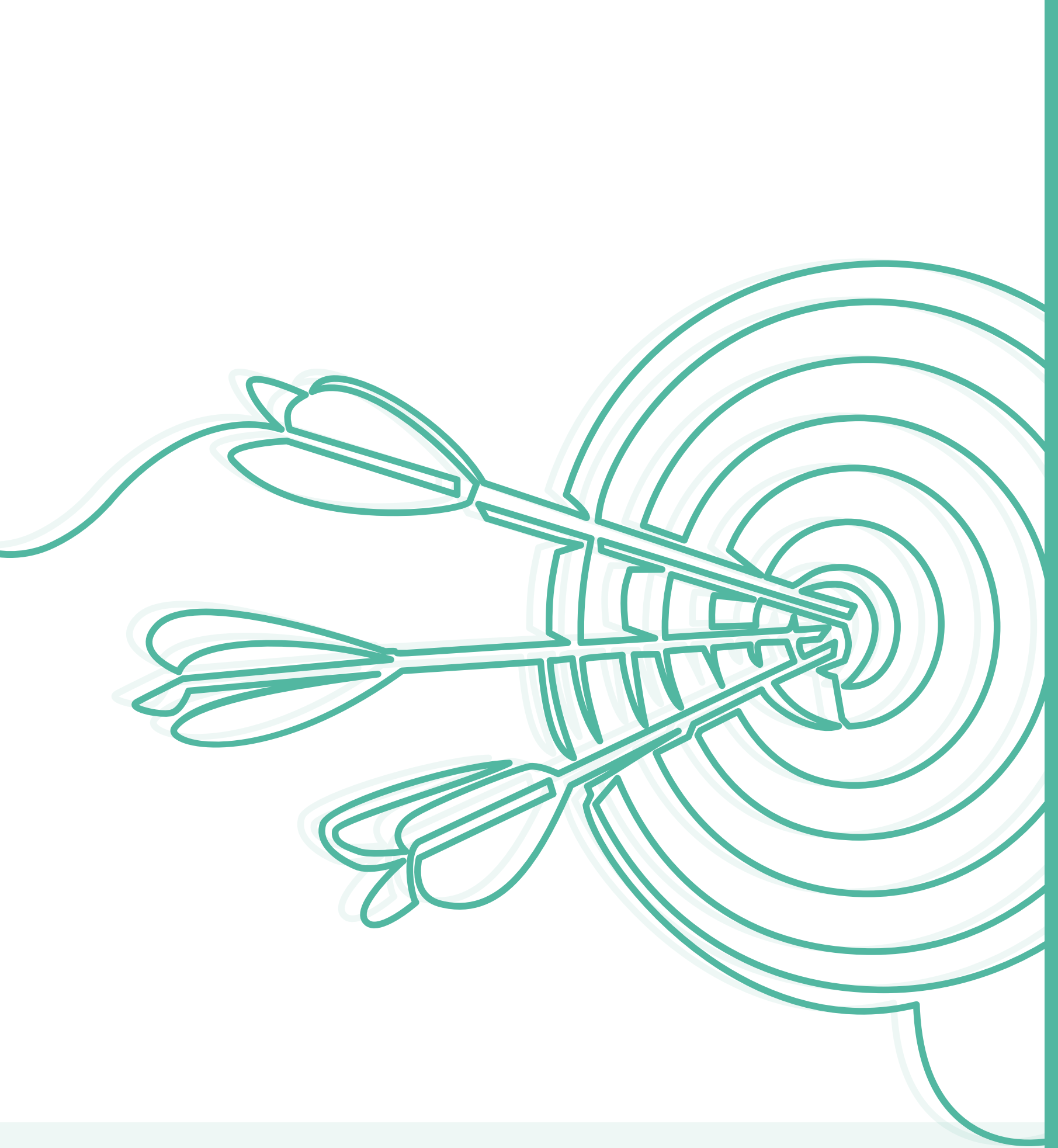
- > move forward to design your initiative and create your investment strategy;
- > recognise the importance of using the same language as social entrepreneurs;
- > develop a better understanding of the issues and concerns you may have about investing in social enterprise;
- > identify the ways in which you can intervene in the market;
- > align your values with your risk appetite and the amount you are prepared to invest.

At this point, you should ideally have done the following:

- > decided that you are a social investor or an intermediary;
- > identified your vision and main objectives;
- > recognised your potential value added;
- > determined your risk appetite.

This chapter addresses questions and concerns of potential social finance investors who have resources and some or significant funding experience in other sectors, but not necessarily in social finance. Investment intuition will be just as applicable in social investments deals, but it needs to be supplemented with knowledge about the targeted social sector and the implementing organisations.

Using information from your market assessment, you have created your vision, identified your niche and potential value added and defined your goals as an investor. You are now in the position to design your social finance initiative and create your investment strategy. This will encompass seven key areas: language, investment focus, model of intervention, type of investee organisation, form and size of investment, co-investment and provision of non-financial support ⁽⁴⁷⁾. The following sections address each of these areas in detail, while Figure 11 at the end of this chapter provides an overview of the investment strategy design process.



47 Based on Boiardi and Hehenberger (2014) and Balbo et al. (2010).

3.1. Language

Before defining your investment focus, it is important to understand that social entrepreneurs and investors struggle to speak the same language. Good intent can get lost in translation. According to Christina Moehrle and Maxime Cheng (from impact finance advisory firm Roots of Impact), access to the ‘right finance in the right form at the right time’ remains the biggest barrier for both start-ups and established social enterprises. Investors want to hear a compelling impact story based on a sound financial bottom line, preferably in language they can easily understand. They also need to understand what they contributed or what can be reasonably attributed to them ⁽⁴⁸⁾.

Social entrepreneurs can feel equally misunderstood. A discussion paper by Oxfam sought to address the mismatch between capital supply and demand by suggesting that investors should ask themselves ‘what kind of skills, support and funding does this enterprise need to be successful, and am I in a position to provide it?’, rather than trying to prove that social investing can achieve market-rate financial returns ⁽⁴⁹⁾. There are a number of examples of educational and networking initiatives, such as those mentioned in the box below, that seek to address this ‘language barrier’ in order to remove a major obstacle in the way of social investment.

EXAMPLE: LEARNING HOW TO ‘SPEAK’ SOCIAL FINANCE

The need to help social enterprises and investors understand each other has led to the creation of the Social Finance Academy, incubated by Roots of Impact. The Social Finance Academy is a free online platform that provides a one-stop-shop for practice-driven, open online education, combined with targeted, personal on-site training in the field of social finance ⁽⁵⁰⁾. The platform has been supported by the Swiss Agency for Development and Cooperation. The platform is international by design, with non-English-language packages added. It is an open invitation to any actor who wants to become fluent in social finance, regardless of where they want to create impact. In the UK, Good Finance ⁽⁵¹⁾ has come out of the Alternative Commission

on Social Investment to improve knowledge and understanding of what social enterprises and charities want from the social investment market. With support from the Big Lottery Fund, the Barrow Cadbury Connect Fund ⁽⁵²⁾ provides grants to develop shared infrastructure resources towards creating a more open and accessible social investment market. One such project is SIIN, the Social Investment Intelligence Network, (a play on the ‘GIIN’ referred to elsewhere). SIIN brings together a group of charity and social enterprise leaders from around England to provide their perspectives on market developments. The group meets quarterly and publishes a short report after each meeting ⁽⁵³⁾.

48 Moehrle and Cheng (2018).
49 Bolis et al. (2017).
50 Social Finance Academy (2019).
51 Good Finance (2019).
52 Connect Fund (2019).
53 The Social Investment Intelligence Network (2018).

3.2. Investment focus

Once you’ve got your mind around the language, your next step is to define your investment focus, namely, what geographical and/or social/environmental sector(s) you want to invest in. Geographical focus is often a given, as most investors are active in their home country, where they are familiar with the language, culture, currency, law, and social and economic trends. Your market assessment may have identified a ‘white space’, both geographically and by sector, and the lack of actors may encourage you to step into that space.

Depending on your vision and mandate or on the source of your funding, you may decide to broaden or limit your focus, for example to a specific region of the country if your investor is a local government. A good case in point is the Stepping Stones Fund launched by the City of London Corporation in 2015 which invests only in organisations in the Greater London area due to the mandate of the Corporation and its charitable arm, the City Bridge Trust ⁽⁵⁴⁾. Many of the pilot projects financed by the EaSI programme similarly chose geographically defined markets within which to operate. In Portugal, this enabled the projects to pilot a business model and tools which in 2019 they plan to make pan-European.

However, you must be aware that too narrow a geographical focus may limit your pool of potential investees, as you will not be able to fund an attractive idea from outside your chosen geography. You may also find that there are insufficient opportunities within your narrow market. This is one of the reasons why social financiers (and commercial investors, for that matter) approach Central Europe as a region, rather than concentrating on individual countries, while others choose to work within themes such as investing in social enterprises to tackle the UN SDGs, often alongside local partners. Finally, you may need to take into account operational, language and currency costs, as well as regulatory considerations,

when choosing a geographical focus. It is wise to conduct market studies before entering a new geography, as having investees in distant locations may mean extra operating costs. You also need to be aware of any possible displacement effect you will have upon existing organisations.

Your social finance market assessment may have identified greater need, demand or return potential in some social sectors/issues or areas than others, for example, in education or healthcare, or in an economically distressed community. As an investor, your choice of sector or area might also be influenced by your background or personal passion if you feel that your investment can make a bigger impact if it is sector focused. Having a sector focus has its advantages because you, as an investor, will become knowledgeable about the social issue after working with the first few investees, and you will be able to use that knowledge to benefit your other investments. It might also be the right approach to take if you are an investor who cares deeply about creating systems change. Over time, increasing your presence in selected sectors can lead to more successful partnership building and co-investment opportunities and thus increased impact through leveraged resources.

However, you should be aware that, as with mainstream investing, geographical or sector focus may lead to greater risk through portfolio concentration. Investing in social enterprises of different sizes, sophistication and impact potential could, of course, mitigate the sector risk. Similarly, if social investment is just one component within your portfolio, it may counterbalance some of the risks elsewhere in your mainstream portfolio. Some social investors who concentrate their activities in specific sectors, for example education, acknowledge that by virtue of their involvement they are engaging in social engineering and need to bear this in mind when assessing impact.

54 City Bridge Trust (n.d.a).

You don't have to choose to concentrate on a specific sector if:

- you are planning to operate in an underdeveloped market with few organisations in any given sector;
- you are aiming at a diverse portfolio;
- you want to demonstrate the functioning and validity of a certain enterprise model regardless of sector.

In Central Europe, the few existing pioneer investors typically do not focus on any given social sector because they do not want to limit their investment pipeline. One consequence of this approach, however, is that it may mean that all investors in one area end up hunting the usual suspects: the most visible and at least nominally viable social enterprises, which seem to be the safe investments. Not having a sector focus may also present challenges further down the line – specifically at the moment of impact measurement and aggregation – as it could prove time consuming and complicated to compare and add up outcomes and impact from very diverse impact areas. You can read more about social impact in Chapter 6.

3.3. Models of intervention

The model of intervention you choose reflects your hypothesis about how social change happens and where you see your value added. Depending on your level of engagement, you may choose to use the logical framework approach or variants thereof, such as goal- or objectives-oriented planning ⁽⁵⁵⁾ while individual investors may trust their instinct. You may decide to invest in start-up social enterprises (see the example of the Impact Hub Milan), consolidated businesses or growth businesses. You can focus your investment in a few organisations that may be large or require long-term intervention, on the other hand, investing in a lot of small organisations can show volume and perhaps create pipeline for others. The attraction of crowdfunding for new investors is that you can invest very small sums across a range of enterprises, building your knowledge but limiting your financial risk.

Your chosen model of intervention will also reflect your thinking about the combination and balance of social and financial return: *Will you invest in organisations that promise significant social impact but can hardly return the capital? Or will you consider social impact and financial viability equally important?* This decision is connected to your vision and goals, your positioning on the investment spectrum introduced in Chapter 1, your responses to the points in Chapter 2 and how you see yourself within the definitions of 'social investor' touched on earlier. Jurisdiction can also play a role in your model of intervention. In French-speaking countries, for example, there is much more emphasis on funds than on loans or direct investment ⁽⁵⁶⁾.

EXAMPLE: IMPACT HUB MILAN DEVELOPS AN IMPACT INVESTMENT FUND FOR LOMBARDY

Impact Hub Milano ⁽⁵⁷⁾ is a member of a global network of collaborative spaces, entrepreneurial communities and capacity-building programmes called impact hubs. It decided to focus on start-up organisations in its pilot project following its assessment of market demand and social investment supply in the Italian region of Lombardy. It had identified a gap in the start-up segment where there was a lack of capital for enterprises seeking to make the transition to the consolidation phase, typically of amounts between EUR 100 000

and EUR 200 000. Impact Hub Milano planned to establish an impact investment fund to provide capital in this range, as well as to provide 'soft' support to investees, consisting of mentoring, coaching and networking opportunities. The fund was thus going to rely on the venture philanthropy model, offering financing and non-financial support to investees. The project generated a handbook for launching an impact investment fund in 2015, but at the time of writing, there is no further information about the fund itself.

A note on crowdfunding

Crowdfunding uses internet platforms to seek finance directly from individuals, corporations and institutions. Although the concept of raising money from friends, supporters and 'the crowd' is at the root of traditional fundraising, crowdfunding has grown in parallel with the exponential development of social media and, similarly, originated in the US. Along with peer-to-peer lending, crowdfunding makes up much of the online alternative finance market ⁽⁵⁸⁾. As with any young activity, there is not yet a universally accepted taxonomy to describe the different actors.

A benchmarking report in 2015 ⁽⁵⁹⁾ found that there were nine categories of business of which the most significant were:

- donation-based crowdfunding
- reward-based crowdfunding

- peer-to-peer lending, divided where possible between consumer and business lending

- equity-based crowdfunding.

Raising capital via crowdfunding is much harder than most enterprises realise because of the supporter or investor acquisition work that has to be done as well as the design of the rewards. Nonetheless, in the UK, crowdfunding has quickly established itself as a genuine alternative to traditional finance. In 2016 for example, equity-based crowdfunding accounted for 17 % of all seed and venture-stage equity investment in the UK, and peer-to-peer business lending provided an equivalent of 15 % of all new SME lending ⁽⁶⁰⁾. However, crowdfunding is not without its pitfalls, such as uneven European regulation and potential enterprise failure. See Annex 7 for more detailed information.

55 There is a lot of discussion on the differences and links between theory of change and logical framework. See, for example, Tools4dev (2019).

56 Of EUR 9.8 billion in 'solidarity savings' in France at the end of 2016, EUR 1.7 billion was in savings accounts with banks and mutuals; EUR 7.2 billion was in solidarity funds, only EUR 502 million was in direct investments and EUR 378 million was in other products. Source: Finansol (2017).

57 Impact Hub Milan (2019).

58 European Commission (2015b).

59 Wardrop et al. (2015). This report is updated every year. In 2016, it gathered data from 344 platforms (up from 255 in 2014) in 27 European countries. The authors estimate that this captures 90 % of the visible alternative finance market. The market grew to EUR 7 671 million in 2016, more than double the amount just two years earlier, at just under EUR 3 billion. Collectively across Europe (excluding the UK because of its distorting effect) the alternative finance market provided EUR 385 million of early-stage, growth and working capital finance to nearly 10 000 European start-ups and small- and medium-sized enterprises (SMEs) in the period 2012-2014, of which EUR 201 million was funded in 2014 alone. By comparison, the 2014 UK figure was EUR 2 340 million, more than 10 times the amount funded in Europe. NGOs, community self-help groups and social enterprises dominate the donation and reward platforms, while mainstream companies dominate the loan and equity platforms. Loan-based investing far outstrips equity and is mostly unsecured. Some deals require all the funding to be raised or none, while others allow enterprises to use what they get.

60 Forbes (2019); see also Cambridge Centre for Alternative Finance (2019).



3.4. Types of investee organisation

The type(s) of investee organisation you choose to invest in will largely depend on your goals, target sector(s) and intervention model decisions. Your choice is closely connected to what financial instrument(s) you are planning to use, which in turn reflects your risk appetite, as discussed in the previous chapter.

Investee organisations are spread on a wide spectrum, which can be overlaid on the investment spectrum we introduced in Chapter 1. Although we are focusing on social enterprises, the impact spectrum includes: non-profit organisations with or without revenue-generating activities; social enterprises; and businesses with a social impact. If your selected social sector is mostly operated by non-profit organisations, you will have no choice but to choose to finance those. In that case, your choice of financial instruments is more limited, as non-profit forms can only take grants and loans and possibly some form of patient capital but are generally not eligible for equity investment. Cooperatives offer a wider choice, as they can issue member shares. If, however, you would like to or need to focus on financially viable social enterprises that have repayment potential, you may have to rely on other support organisations to work with non-profit investees in the pipeline.

According to European Venture Philanthropy Association (EVPA) members NESsT and Oltre Venture, who provided input for the *Learning from Failures in Venture Philanthropy and Social Investment* publication ⁽⁶¹⁾ non-profits are difficult to move to sustainability and their revenue-generating potential is limited if they are not willing to engage seriously in entrepreneurial solutions. This in turn may mean that the potential large-scale social impact of non-profits is limited as well, which has implications for the social return of your investment portfolio, a key consideration when you are designing your investment strategy. This may lead you to consider hybrid instruments in your portfolio. The 2017 Impact Investor Survey shows that this segment of investors has a clear preference in terms of the types of investees ⁽⁶²⁾: 78 % of allocated capital was invested in post-venture stage businesses, including growth (38 %) and mature stages (46 % in private and publicly traded), as opposed to early-stage and start-up enterprises where unmet need is most apparent, but also where individual amounts required are likely to be smallest.

3.5. Form and size of investment

At its simplest, social investment is the provision of finance to an enterprise, which then uses this finance to expand its operations, develop new income streams, fund working capital or reduce costs and, in so doing, create or increase its social impact. These investments need to have an attached income stream or cost-substitution effect that is sufficient to cover not only operating expenses, but also to repay the investor, usually with interest (e.g. mortgage payments, which may be less than rental costs and which also give the enterprise security of tenure). Social investment is

not a source of income for social enterprises in itself, but rather a means to an end. As we have noted above, investors pursue a range of financial returns, which will vary according to their investment strategy and impact ethos. Respondents to the 2017 Impact Investor Survey, referenced above, broadly agreed that below-market-rate capital plays an important role, with only 6 % disagreeing; 89 % agreed or strongly agreed with the idea that 'there are certain impact investment strategies that do not (and may never) lend themselves to risk-adjusted market rates

61 Boiardi and Hehenberger (2014).

62 Mudaliar et al. (2017).

of return'. This blended approach to return can also act as a bridge between philanthropy and market-rate capital by not forcing the pace of financial return and helping to reduce the risk of certain investments for other investors. Investment that does not seek market-rate returns generally works best for seed and early-stage business models, frontier markets and aspects of education, health and social care and the arts where financial return is more challenging.

On the surface, there appears to be a wide range of social investment products, but most fall within one of the three main categories referred to in Chapter 2: debt, equity and quasi-equity.

Debt is the most common type of investment. An investor lends money to a social enterprise either for a specific purpose or for general funding needs. The enterprise then repays the loan over an agreed period, sometimes on an interest-free basis, otherwise at a pre-agreed or floating rate of interest. As seen earlier, historically, social investors have charged interest on an affordability basis rather than by pricing the loan on the perceived risk. Debt is spread across **secured loans, unsecured loans** and **bonds**, as discussed in more detail below.

Equity is where the investor receives a stake in the enterprise, most commonly in the form of shares, in consideration for their funding. As of today, equity remains only a tiny portion of social investment, as many social enterprises and third sector organisations do not have structures to permit them to issue shares or pay dividends. As we will see later in this guide, community shares have become popular ways for community-based social enterprises to raise finance while member shares are a long-accepted way for cooperatives to raise finance. Although community shares are repayable, many investors are less concerned with principal repayment and more with securing a small income, often enhanced by tax relief.

Community share issues originated in the UK, but this practice has since spread to more than 20 different European countries as well as Australia and North America where they have financed community sports enterprises such as ice hockey clubs ⁽⁶³⁾. However, where equity is provided, it should generally be regarded as permanent investment: there are hardly any mechanisms for the resale of social enterprise shares, let alone ways to value them. And in some jurisdictions, sales are restricted to par value. There is very little liquidity, so even where a matched bargain mechanism exists in theory, it may take a considerable time to match a willing buyer with a seller. Equally, one reason that social enterprises are reluctant to be listed on mainstream exchanges is their desire to protect their mission against dilution or takeover. Shares have ownership and therefore governance implications. Enterprises should always have a shareholder agreement with investors to avoid any misunderstandings later on; this is especially important for mission-driven organisations.

Quasi-equity has come to the fore because of the difficulties in issuing classical equity; it is an equity-style structure for organisations that cannot issue shares. Quasi-equity investments can be fairly complex to agree on and document. Instead, they often take the form of revenue participation agreement.

Integrated capital, often referred to as **staircase funding** is the coordinated use of different forms of money (equity, loans, grants, gifts, guarantees and so on) often from different funders, to support a developing enterprise where there is potential for significant social impact. It can be ideal for social enterprises breaking fresh ground and in need of patient capital. It allows for longer development times by including some types of finance that don't need to produce a financial return, such as grants. In so doing, it can get enterprises through the 'valley of death' – that difficult area where they have a promising enterprise

model, technology, product or service and need more capital to realise their potential, but don't qualify for traditional financing. If community foundations and local investors participate, integrated capital can anchor future success within the community. Such structures allow investors with different risk/reward appetites to work together in support of potentially high-impact enterprises. It is different from **hybrid finance**, which is discussed within the coming pages. Integrated capital is also subtly different from **blended capital/finance**, which is the strategic use of development finance, often from a public agency, and philanthropic funds.

The examples above are all direct investments, although integrated capital also introduces contingent investments. For example, you can provide a

guarantee to a third party on behalf of the enterprise or by **underwriting** an amount that may encourage further investors or that you may be willing to provide at a later date.

Guarantees have also been used by philanthropists, public sector agencies, governments and the EU to encourage private investment in social enterprises. The EaSI guarantee facility described in Annex 6 is an instrument managed by the EIF and is available to social investors in all Member States. The example of Erste Group in Section 3.5.3. illustrates how a bank used this guarantee (and funding from another EaSI programme) to build its investment strategy in Central Europe and the business model for its social banking initiative. Guarantees, their definition and types, are addressed in more detail in the glossary.

3.5.1. Financial instruments

Table 6 provides a summary of the main financial instruments and their implications for social enterprises and investors. Common forms of debt include **secured and unsecured loans, mortgages, working capital** and **with-recourse receivables financing**. A highly publicised instrument is the **social impact bond** (SIB), which was developed with the expertise and structuring techniques of City of London professionals. There is a growing amount of literature about this instrument, which is referenced in the glossary. SIBs are not true bonds; they are essentially contracts through which the public sector or a governmental body commits to paying for improved social outcomes. Rather than provide the service itself, the state or the commissioning body contracts social investors

who provide the capital for one or more third sector enterprise(s) to deliver a set of interventions. If the improved social outcomes are achieved, the state pays investors back and provides them with a financial return. If there is no performance uplift, the investors can lose money. The theory is that improved social outcomes create significant savings to the public purse from which investors are repaid ⁽⁶⁴⁾. As concerns grow about the efficacy and efficiency of official aid flows, outcomes-based funding instruments have embraced development impact bonds (DIBs) ⁽⁶⁵⁾. These have tended to be designed as single investments for a single intervention in a specific geography, however such a restricted approach may limit their scalability ⁽⁶⁶⁾.

63 See also Get Mutual (n.d.), which also examines the Australian regulatory environment for crowdfunding for cooperative securities.

64 By early 2018, 108 impact bonds had been issued around the world, raising almost USD 400 million, touching just over 700 000 lives according to Social Finance UK (2019).

65 As of the end of 2017, five DIBs had been contracted with a further 24 in development, according to Social Finance UK (2019).

66 See also 'outcome funds' in the glossary.

Table 6. Financial instruments

Instrument	Terms		Implications for social enterprise	Implications for investor
1. Gift				
Grants and gifts	Duration:	One-off (unless multiple)	• Unless unrestricted, use may be restricted for predefined work • May have high fundraising and/or time costs • Low entrepreneurial flexibility unless unrestricted	• 100 % risk • Unless stated, no clawback if money not spent or misallocated • Only return is social
	Payments:	None		
	Repayment:	None		
2. Repayable finance				
Debt capital	Duration:	Normally 3-7 years; up to 25 years for a building purchase	• If payments are contracted, debt capital will require a low-risk financial model • No dilution of ownership; far-reaching rights of provider in event of default or late payment • Entrepreneurial flexibility within overall terms	• Investment may be secured against assets • May reduce risk of loss • Higher risk if unsecured • Regular payments allow you to track financial stability • Social and financial return
	Payments:	Interest payments and capital repayments		
	Repayment:	Yes		
3. Semi-repayable finance				
Guarantees	Duration:	Various, usually 6 months to 5 years	• Loan terms should reflect reduced enterprise risk for investor • Can be used to unlock down payment to enable you to purchase resources • If the loan is not repaid or work not done to the investor's satisfaction, the guarantee can be called and is immediately payable or converted to loan or equity (rarely a gift)	• Contingent risk, so no money is provided up-front • You can keep your money invested unless required to deposit with lender • Can take many forms. They may be structured to take an agreed percentage of the financial risk in the project. They can be used to unlock an advance payment or can be used by the contractor to 'insure' against the risk of non-performance • Can be on demand or conditional • Less control than direct investment, so can be higher risk • Impact first
	Payments:	Fee often payable quarterly, in advance		
	Cancellation:	Yes, usually 6 months after maturity, if terms of loan are complied with; can be cheap, but includes fees in addition to the cost of loan		

Mezzanine capital	Duration:	3-10 years	• If interest is contracted, predictable cash flow will be required • Revenue-sharing with investor • Dilution only if loan converted to equity	• Interest income and equity or revenue share • Illiquid, especially if equity conversion • Medium to high risk • Impact first
	Payments:	Interest payments, may be stepped		
	Repayment:	Yes		
Hybrid capital	Duration:	Usually 3-7 years	• Can be inexpensive, but can also be complex • Usually no dilution • Risk-sharing with investor • Structuring flexibility	• Limited rights • Risk-sharing • May be complex and expensive • Investor may be able to secure income streams as security • Medium to high risk • Impact first
	Payments:	Various		
	Repayment:	Depends on structure		
4. Equity capital				
	Duration:	Unlimited	• Dilution of ownership • Profit participation • Possible impact on mission • Flexibility of use	• Voting rights and possible control • Profit participation • Limited to zero liquidity/secondary market • Long term • High risk (unless the business model is proven) • Usually impact first
	Payments:	Dividend if in profit		
	Repayment	Yes		

Equity often takes the form of ordinary **shares**, although in mission-driven enterprises, preference shares are also in issue, which separates the governance of the organisation from the preference for dividend payments. Some values-based financial intermediaries, such as Triodos Bank in Europe, issue depository receipts. These receipts enable the enterprise to raise new capital while ensuring that the organisation cannot be taken over by a hostile bidder, thereby protecting the mission and values of the enterprise. Ownership and risk to mission and shared values are of fundamental importance to a social enterprise when negotiating

the injection of new capital. Other social enterprises, such as Charity Bank, have locked their mission into their articles of association.

The French legal environment, on the other hand, offers a unique way of investing equity into social enterprises: it enables retail investors to invest in social enterprises through the '90/10' solidarity investment funds run by intermediary organisations. This instrument is described in some detail in the example below. The basis for the implementation of such model is a specific legal provision that only exists in a few countries at the moment.

EXAMPLE: SOCIAL SOLIDARITY INVESTMENT IN FRANCE

Over the past 40 years, France has introduced financing tools for solidarity organisations (*finance solidaire*). This includes social enterprises, with particular regard to their ability to absorb equity, although social finance in France encompasses all financial savings products that allow individuals to invest directly or indirectly in a project or social enterprise with a strong social and/or environmental purpose. In 1983, participating equity was created as a combination of fixed remuneration and variable remuneration indexed to the performance of the investee company in order to finance the development of cooperatives.

In 2001, 90/10 solidarity investment funds were established to channel long-term (i.e. for retirement), low-rate employee savings into ‘solidarity-designated’ social enterprises. In these funds, 90–95 % of the employees’ portfolios remain in classic, listed securities, while 5–10 % is invested in solidarity-designated organisations. Social enterprises have to meet specific criteria in order to become eligible for such low-rate investments from 90/10 funds ⁽⁶⁷⁾.

By 2017, solidarity finance had resulted in total assets under management of EUR 11.5 billion, divided into four investment vehicles, as shown in the table below.

Investment vehicle	Distribution	Total assets	Detail
Savings accounts	Banks, insurance companies	EUR 2.2 billion	Two options: • funds are used to invest directly in social enterprises • 25–100 % of the annual interest payment from savings accounts is donated to an NGO or association
Solidarity funds	Banks, corporate employee savings schemes, funds	EUR 585 million	Mutual funds: 90–95 % of the portfolio is invested in the stocks and bonds of listed companies and 5–10 % in social enterprises
Direct investments (i.e. shares or bonds)	Social enterprises	EUR 8.6 billion	By purchasing shares or bonds offered by a social enterprise, individuals can invest directly to assist their growth and development. Under European rules, such investors can claim tax relief
Life insurance	Banks, insurance companies, mutual societies	EUR 188 million	Life policies in euros that may be unit linked (i.e. giving users both investment and insurance opportunities)
Total assets		EUR 11.5 billion	

Source: *Finansol* (2018b)

The final figures show that a total of EUR 352.4 million was invested in social enterprise in 2017. In terms of impact, *Finansol* calculated that: 1 300 enterprises and associations were financed; 19 000

microcredits were disbursed for entrepreneurship; around 45 000 jobs were created or preserved; and more than 80 economic development actors were supported in developing countries ⁽⁶⁸⁾.

Quasi-equity often involves an investor providing finance to enable a future initiative that may generate income for the enterprise further down the road to get off the ground. The **loan** may be repayable with interest or payable as a **royalty** payment that is only payable if certain income triggers are met. Such conditionality may also extend to repayment of the principal. There are a number of variations on this theme, including a minimal interest payment that ratchets up as targets are met or outperformed. The essence of quasi-equity is that the investor is taking equity-type rather than loan-type risks because payment is far from ensured. Given the uncertainty of many social enterprise projections, this often requires the investor to be flexible in their approach.

Recently, advisors have sought to reconcile some of the basic tensions between the financial requirements of investors (positive financial return) and the impact motivation of social entrepreneurs (for whom social return is paramount) by developing new corporate structures, such as low-profit limited liability companies (also referred to as L3Cs) and community interest companies (CICs). The intention was to use these structures rather than just complex financial instruments, but they have not yet found a balance between the interests of investors and enterprise.

Hybrid finance has sought to address the same issues, as well as the concerns of mission drift and sell-out. It can be defined as a combined face of equity and debt, and includes preference capital, convertible debentures, warrants and innovative hybrids (where a debt instrument is blended with derivatives such as a swap or forward option) and mixtures of debt and grant.

There has been much debate as to whether these forms of finance are to be classed as equity or debt, and you should seek advice if you are considering either using or investing in them, and in terms of how you would account for them in your portfolio. Many of these forms of finance been translated straight from the investment banking world and will only be of relevance to sophisticated investors or the very few social enterprises that have the skills to manage them. A champion of one-on-one hybrid financing deals in Europe has been the intermediary FASE, whose example illustrates the success and challenges of operating a model that offers such complex tailor-made finance packages.

A more recent initiative has been the issue of flexible low-yield (FLY) paper by Google. Social entrepreneurs and social investors share a mutual mistrust. FLY paper removes the financial temptation for entrepreneur and investor defection and allows investors and entrepreneurs to credibly signal a reciprocal commitment to the pursuit that blends profit motive with a social mission ⁽⁶⁹⁾. We are not aware of any applications of FLY paper to date, but it could be an interesting tool for programme-related investing by a foundation. If the future expansion of the social investment market will come in any significant way from retail investors, and they do not have the resources to police a balance between social mission and financial returns, they will need such a robust, off-the-shelf remedy for the mistrust that keeps social investors and entrepreneurs apart ⁽⁷⁰⁾.

67 Dupuy and Lagendorff (2014).
68 *Finansol* (2018b).

69 Reiser and Dean (2013).
70 Burgess (2014).

EXAMPLE: FASE DEAL-BY-DEAL ‘HYBRID’ FINANCING

Finanzierungsagentur für Social Entrepreneurship (FASE) is considered to be one of the leading financial intermediaries supporting early-stage social enterprises with outstanding impact potential to raise growth capital in Germany.

Phase 1:

In its first pilot project (2014-2016), FASE was testing its model of cooperation and co-investing of different financing partners for social enterprises. FASE successfully brought different types of investors to the table around specific investment deals, but also played the role of the advisory organisation through to external coach, helping the investee organisation become ready to absorb the investment. Four out of five social enterprises FASE selected and developed during the pilot have successfully received a financing package for growth capital. These packages combine impact investments through mezzanine finance (quasi-equity) with features such as revenue or profit participations, impact incentives with equity or donations and quasi-equity, and – in one case – crowdfunding with impact investment. One of the many lessons learnt is that the way financial instruments are combined for a specific social enterprise depends very much on the organisational structure of the investee – that is, equity solutions were more appropriate for ‘for-profit’ social businesses, while mezzanine finance was a more suitable solution for ‘hybrid’ organisational structures. The FASE approach was highly tailored, with each transaction responding to the specifics of the investee. This carries clear advantages for the social enterprise, providing appropriate life cycle financing and, for the participating investors, reducing their risk and testing new cooperation models. The pilot demonstrated that the innovative combination of existing financial instruments could channel significant resources into selected enterprises. At the same time, this is a very resource-intensive process, which was expected to be difficult to implement and which could only be scaled successfully in its original form if an increased market volume allowed more deals per year.

Phase 2:

FASE believed that higher market volumes existed in a wider European market and decided to scale its model with further EU funding in a second project also funded by the EaSI programme (2016-2018). Building on the learnings of the pilot, the objective of the second project was to prepare the Europe-wide roll-out of the customised deal-by-deal support model. This included the following activities:

- detailing alternative models for the roll-out of deal-by-deal support to more European regions;
- preparing market entry in selected pilot regions (e.g. market assessment, business planning, building of investor/partner network and deal sourcing);
- piloting and testing alternative roll-out models in two selected growth regions (Benelux and Austria/Central Eastern Europe);
- piloting and testing pay-for-success models with hybrid transaction support for one to two social enterprises in Germany or Austria;
- setting up and testing an early-stage co-investment fund in Germany or Austria to channel more investment capital into the social finance ecosystem (including finding a fund partner, developing fund contracts and approaching investors);
- knowledge dissemination.

During the 2 years of the roll-out phase, FASE learnt a lot about the social finance markets in European countries and the possible expansion of its services, as well as about the feasibility of deal-by-deal support, as outlined below.

- Although matching investors with social enterprises on a deal-by-deal basis is very time consuming, it has proven very effective, as it allows for the most suitable combination of financing instruments to meet the needs of the social enterprise.
- In FASE’s portfolio, most hybrid social enterprises (usually with non-profit legal forms) opted for quasi-equity type instruments (e.g. mezzanine finance), while for-profit formations chose equity. It therefore seems that a key element in the investment discussion is the legal structure of the investee.
- Deals will not (or are less likely to) happen without persistence and encouragement from the intermediary.
- European markets continue to be very diverse, therefore each country needs customised approaches and models to fit the existing social finance ecosystem.
- Due to the above reasons and the nature of early-stage social enterprises (mostly targeted by FASE’s strategy), transaction costs continue to be very high for deals with a value of less than EUR 250 000.

FASE has supported more than 40 social enterprises in Germany, Austria and Benelux so far, raising more than EUR 15 million in hybrid financing to scale their business and impact models.

3.5.2. How to select the right instrument

When choosing a financial instrument, you need to think about your values, mission and strategy, as well as the best way in which you can assist the enterprise. You also need to know whether one type of instrument is more common in the jurisdiction you intend to invest in. This can be difficult if you have little experience of making social investments. In some cases, you could simply give the enterprise the money, but if it is feasible, you may be attracted to the idea of a loan. You may also be willing to lend a larger sum than

you would be prepared to give ⁽⁷¹⁾, knowing that you expect the loan to be repaid. However, a grant may be more desirable in the eyes of the enterprise because no repayment is required. In certain circumstances, a grant may have tax benefits for you and/or the investee, though a social investment may do too. More detailed information on social investment tax relief available in European countries will be published in 2019 in a European Commission synthesis report on social enterprises and their ecosystems in Europe ⁽⁷²⁾.

71 Research for the launch of Charity Bank indicated that people were likely to lend GBP 10 for every GBP 1 they would donate.

72 The synthesis report will be drawing on country reports, most of which are already available at <https://ec.europa.eu/social/main.jsp?catId=952&intPagId=2914&langId=en>. Once available, a link to the 2019 synthesis report will be published on the same webpage.

When you are deciding whether social investment is the best way to finance a social enterprise, you need to consider some hurdles, regardless of financial instrument.

Is there an income stream or cost-substitution effect that will repay an investment?

- ✓ If yes, keep going.
- ✗ If not, consider a grant or non-financial support or walk away.

Does the sector in which the enterprise operates have a track record of such investment?

- ✓ If yes, you are on the right track.
- ✗ If not, only go ahead if you are happy with the risk.

Does the enterprise itself have a credit history?

- ✓ If yes, go ahead.
- ✗ If not, but you are happy with the risk, you may still go ahead.

Is the organisation at the optimum stage of development? (Enterprises at different stages of development are more or less suited to repaying investment.)

- ✓ If yes, go ahead.
- ✗ If not, but the enterprise is moving in the right direction, you may still go ahead.

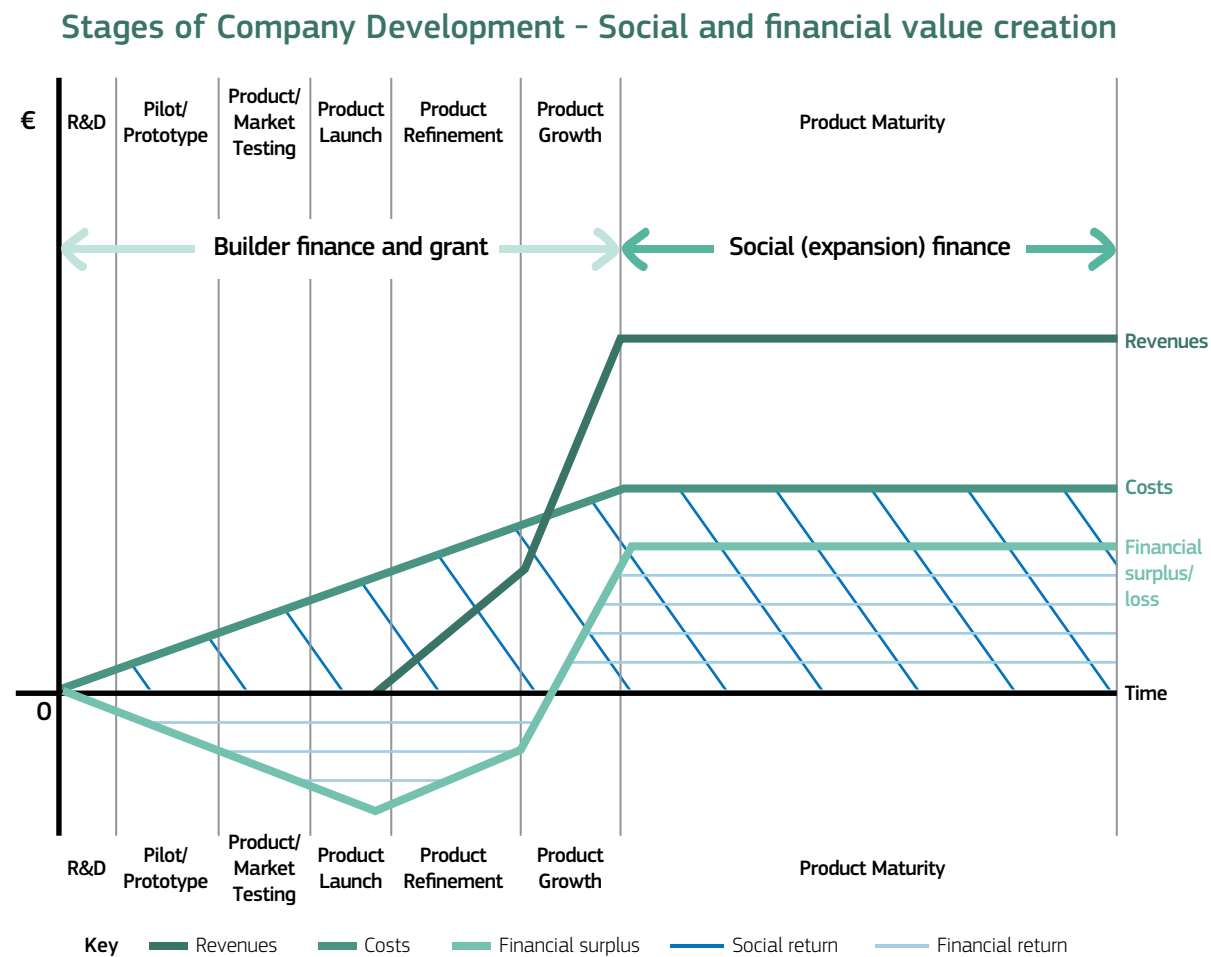
Has the model already been tested and is it proven to generate social and financial returns?

- ✓ If yes, go ahead.
- ✗ If not, but you are prepared to take the risk and back the enterprise, go ahead, although consider investing a lower amount

How you answer these questions may help you to determine which type of instrument you may wish to choose. If the answer to all of the above questions is ‘no’ and you still want help the social enterprise, it may be best to give a grant. Not all activities that an enterprise undertakes will provide income immediately or, indeed, ever.

As Figure 9 shows, the first phases of product development and launch assume increasing costs (and thereby increasing investment), as well as slowly increasing revenues for the social enterprise. Though the enterprise is making losses at this phase, the social return may already be significant. Here, a grant may be appropriate – either alone or alongside investment – but there may also be an appetite to provide a high-risk investment, via either quasi-equity, hybrid investment or direct equity injection. In the product maturity phase, repayable social finance may be used, as costs, revenues and returns become stable.

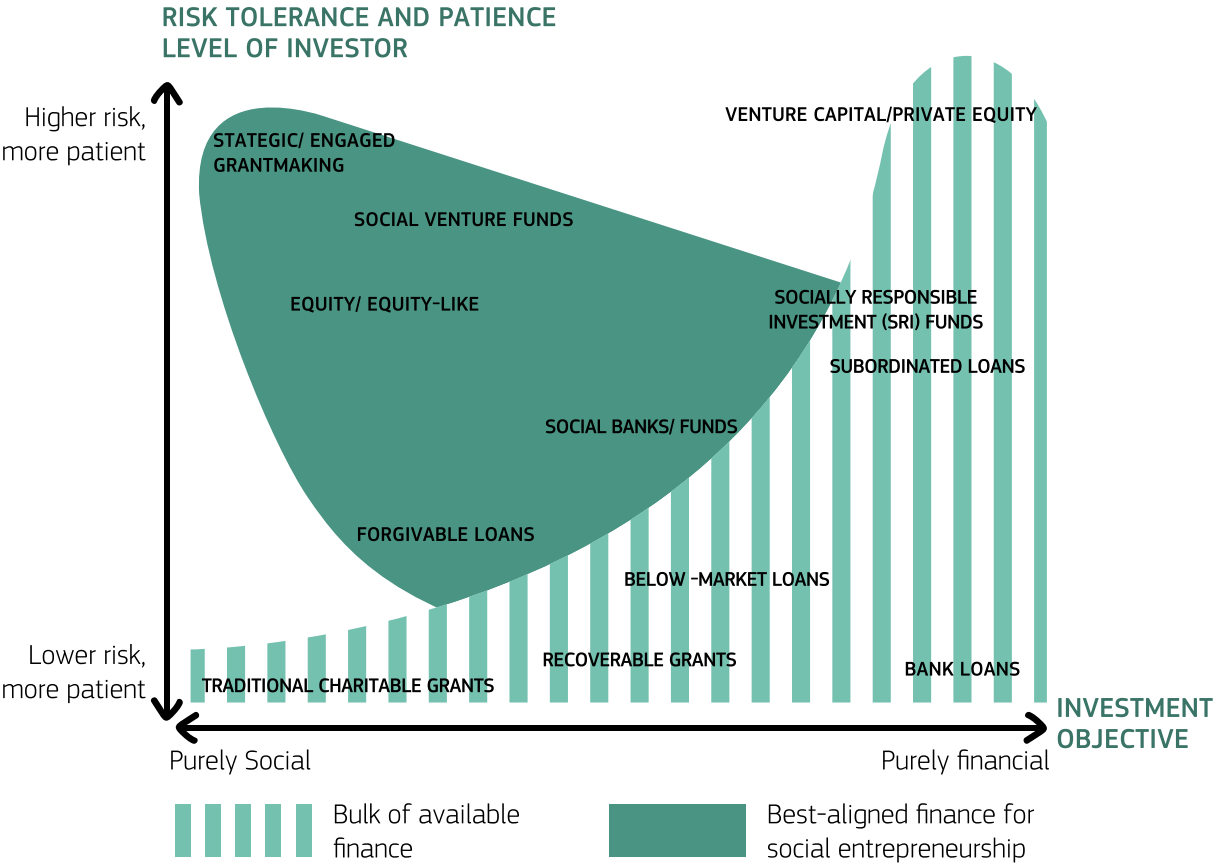
Figure 9. Social and financial value creation



Social investment covers a range of assets, from cash to property. A fuller guide to the different types can be found on the KnowHow website (73). As has been pointed out, the majority of social investment to date has been loan driven, often by values-based banks. However, there is also strong demand for patient or start-up capital. If we plot the investment objective along an axis from purely social to purely financial,

and against the risk profile of the investor, we see that the best-aligned finance is the least available (see Figure 10). What might be right for you as an investor may not be what social enterprises need most. This dilemma can be tackled in your basic design considerations, with a better understanding of risk and your willingness to accept it. Short-term solutions can include partnerships and mixed funding.

Figure 10. Investment opportunities in social investment
Source: © Skoll Centre for Social Entrepreneurship, 2008, in Nicholls and Pharoah (2008)



3.5.3. Basic design considerations

The most important consideration as an investor is whether your support is seeking to help the enterprise achieve its goals or mission. The design of your investment should not place undue burdens upon the enterprise that restrict its ability to perform or, perversely, make it more difficult to deliver impact. It must, however, also work for you and enable you to achieve what you want from your social investment strategy and fall within your risk profile. If you have a choice and you are impact led, ask yourself: **Will one design have more impact than another?** The repayment of a social investment can lower the initial social impact of the investment, compared to, say, a grant. This is because the enterprise has to find the means to repay the investor and potentially service the investment from the outset. If the cost of repayment is small compared with the benefit accrued from scaling up, this may be acceptable, but it should not be overlooked that the cost of repayment risks placing a future burden on investees. This is one reason why, to keep repayments lower, many social investments do not fully price the risks that are being taken.

In venture philanthropy, the key is to select the tool that offers the best fit. The preferences of the social purpose organisation (SPO) (74), rather than those of the venture philanthropy fund, should be the primary determinant. Nevertheless, as part of its general investment strategy, the venture philanthropy fund will need to assess in advance which instruments it plans to employ (75).

Another design consideration is, if you take security, **what will you do if the investee defaults? Will you enforce the security? Do you have the resources to work through the situation with the enterprise and possibly refinance the investment on more affordable terms?** Many social investors take security to give them a seat at the table if the investment has to be refinanced and to position their interests relative to those of other investors. Others point to security as a way of reinforcing that the money is not a grant. **Do you have the skills and the time to take over the running of the enterprise if necessary? If you have to shut the enterprise down, what assistance can you give to the employees, the beneficiaries or customers?** You also need to consider whether the asset you are financing and holding as security has any residual value if it is being used intensively.

You can delegate design by investing through one of a growing number of fund structures. There are trade-offs between direct investment and investing through an intermediary (see also Section 2.1.). However, if you want to invest in several specific sectors at the same time that may be seen as ‘unpopular’ or ‘unattractive’, you may struggle to find a fund that meets your objectives.

73 KnowHow (n.d.).

74 SPO is a term used in venture philanthropy that encompasses organisations that are not necessarily established as enterprises. See glossary.

75 Balbo et al. (2010).

EXAMPLE: ERSTE GROUP USES EASI INSTRUMENTS FOR SOCIAL ENTERPRISE FINANCE

Erste Group, one of the largest financial services providers in Central and Eastern Europe, has been active in social enterprise support for over a decade with the ERSTE Foundation offering grants to social innovation and social finance initiatives. However, it has only been in recent years that the business case of banking products for social enterprises started to be studied seriously. The development of the social enterprise ecosystem and the increase in the number of successful social enterprise models encouraged Erste Bank to consider social businesses as potential borrowers and investees. To do this, Erste Bank launched a Step-by-Step programme in 2016 as part of its social banking initiative. It targets low-income clients, entrepreneurs that are just starting out and social organisations, offering them tailored financing as well as financial education, business training and mentoring support. The aim of the programme is to provide customers with financial stability and thereby contribute to the economic development of the Central European region, where the bank has business interests.

At the same time, Erste Bank recognised the need to learn more about these target groups and educate its own organisation about the related opportunities and challenges. The 2016-2018 round of EaSI funding provided an opportunity for the bank to do both by participating in pilot projects in a number of Central European countries. The bank strategically used EaSI facilities to become engaged with start-up and consolidated social

enterprises and to pilot social finance instruments to support them.

- **Supporting early-stage social enterprises:** In a Hungarian joint project with IFUA Nonprofit Partners, more than 60 social enterprises received capacity-building support thanks to a grant funded by the EaSI programme. ERSTE Foundation co-funded this project, called SEEDS, and offered seed grants to 10 of the most successful business models. As a result, some of the funded businesses may be successful in pitching for repayable finance to social investors in the near future. Erste Bank indicated its willingness to continue supporting a SEEDS follow-up programme and to roll out the SEEDS programme to other Central and Eastern European countries where Erste Bank operates.
- **Piloting loans to social enterprises that are ready to scale:** As part of a joint project with Smart Kolektiv in Serbia, Erste Bank Serbia offered loans to four social enterprises that had received mentoring and business planning support from Smart Kolektiv (see more detail of this project in Section 1.3.2.). The research and capacity-building elements had been co-funded by the EaSI programme. The loans are the first to be given under Erste's Social Banking Initiative, which it is planning to roll out in the whole region.

- **Rolling out social banking products using the EaSI guarantee facility:** In 2016, Erste Bank Serbia signed a guarantee agreement with the EIF to cover a loan portfolio of EUR 4.7 million for about 850 microbusinesses, including social enterprises ⁽⁷⁶⁾. This was followed by a EUR 50 million deal signed by the EIF and Erste Group in 2018, allowing all seven Erste Group member banks to grant loans at reduced interest rates and with lower collateral requirements to social businesses and non-profit organisations ⁽⁷⁷⁾. These guarantees are used for backing the pilot loans in the Serbian project mentioned above, but also paved the way for the development and introduction of banking products in other countries, for example Hungary in July 2018. Erste Bank sees the EaSI guarantee as an appropriate, flexible facility, which would allow it to achieve the intended impact fast, as the guarantee can be used in seven countries. It helps limit the risk position of the banks and turn small loans (be it for working capital or investment) into profitable banking products over the years.

Erste Bank has largely followed the social finance 'recipe' in the sense that it devoted a lot of time, energy and resources to in-depth research of the market and getting to know the key players. It then articulated its vision and goals and designed investment strategies in each of the countries (i.e. via the individual banks), but also for the Central European region as a whole (via the Foundation). Using EaSI funding, partner resources and their own money, Erste Bank has piloted a number of different models, used the learnings to refine them and plans to roll them out over the next few years. The plan is to provide over 500 social organisations with a total of EUR 50 million in loans over the next 5 years in Austria, Croatia, the Czech Republic, Hungary, Romania, Slovakia and Serbia.

76 European Investment Fund (2016).

77 Erste Group (2018).

3.6. Co-investment: Advantages and trade-offs

Co-investment can be an important part of your investment strategy. The key condition, of course, is that there are potential co-investors present in the market and that they are open to such partnerships. In an ideal case, you should have identified a number of possible co-investors during your assessment of the market. If you have identified a pool of possible partners, you need to decide whether you need them all. *What is it that co-investors can bring to the table that may increase the value added and, ultimately, the desired social impact of the investees? Do you need additional capital, skills or networks? Can they contribute special industry expertise that you can't access otherwise? At what point during the life cycle of the investment do you want to include them? From the beginning, or later? For follow-on investment with you during consolidation, or in the growth phase?* Table 7 helps you think through the advantages and disadvantages of involving co-investors.

Once you have decided that you will seek out co-investment, you will need to take into account a few factors when selecting the co-investors.

- **Are you looking for co-investors for a fund or on a deal-by-deal basis?** While the latter is possible, it will require more resources and possibly an intermediary that coordinates co-investors of different interests and that may even be providing different types of financing, for example, to create a hybrid financing package. ClearlySo is an interesting example of such an intermediary, as detailed in Chapters 4 and 7.
- **Are the co-investors in the same position on the investment spectrum as you?** If you have defined yourself as an impact-first investor, you will be looking for impact-first co-investors whose interests in achieving social impact are likely to be aligned with yours. This can prevent potential future disagreements when difficult decisions might have to be made to balance social impact and financial return.

- *Do their resources complement yours, and in what way? Are you looking for someone to invest significant amounts of money alongside you?*
- *Do they offer the expertise and skills that you are missing? Are you willing to give them what they are asking for in exchange?*
- *Do they have a good standing and reputation? Do they have investment experience in your sector/area? Do they bring reputational risks?*
- *Are they willing to share the burden and cost of management?*
- *Can you foresee potential problems upon exit in the future?*
- *Are you in a hurry?* Partnerships can often take time to work out.

Once you have selected your co-investor(s), it is crucial that you agree on the roles and responsibilities up front. This includes not only the financials, but also who does what in the investment process: for example, how the co-investor might get involved in sourcing deals, in due diligence and the actual management of the investments. If you are the lead investor, what are your information sharing and reporting obligations towards your co-investors? How often do you report? In legal terms, this is referred to as a duty of care. You will need to ensure there is no conflict between your duties to your investee and your duties to your co-investees.

Table 7. Advantages and disadvantages of involving co-investors

Advantages	Disadvantages
• More funds and resources available for target organisations • Spreads risk • Additional validation of the investment opportunity • Shared risk in case of failure • Shared risk should additional funding be required • Target organisation is not fully dependent on one funding source • Shared reporting on impact (normally a considerable cost for investee) if funders all align on which impacts should be measured • Combined due diligence and agreed terms between co-investors increases speed and reduces costs	• Additional liability for fund management organisation • Fund management cost ratios may increase • Possible loss of control over investment • It can require more resources

3.7. Non-financial support

3.7.1. Use, forms, advantages and disadvantages

Non-financial support is seen as a key component for social investors who wish to engage with their investees. In addition to adding value to the investment, non-financial support has an important risk-mitigation purpose for the investor:

- it may increase sales thanks to additional contacts or sales opportunities offered by the investor and so improve the bottom line of the business;
- it may improve the skills or systems of the investee organisation by adding expert knowledge or equipment, and thus make the operations of the business more viable;

- it may help make the enterprise more transparent and the governance more robust by involving the investor in the board of directors or in an advisory function.

In addition to your desire to become engaged with your investment, the risk mitigation effect is something to take in to account when you are deciding if you wish to include non-financial support in your investment strategy as this helps the investee to make better business decisions. You can provide non-financial support directly, if you have the means and skills, or you can outsource this to a support organisation or intermediary and pay for capacity building and consulting. In most cases, the provision of non-financial support is resource intensive, so it needs to figure in your cost calculations as well as in the strategy.

3.7.2. Who should provide non-financial support?

This consideration assumes that other players exist in the support segment of the market who are capable of delivering support to social enterprises: that is, consultants, support organisations or intermediaries that can be paid to provide support to individual investees and who understand the market.

An investor may also decide to fund other organisations to run large support programmes with the aim of strengthening or building the market and the investment pipeline. The mechanism is often that of a competition, which allows social enterprises with successful applications to the programme to choose a support provider from the market or an approved list and to pay for their targeted support in the form of a project. Such programmes could offer long-term support over several years, or provide short-term, one-off capacity-building or investment-readiness intervention to social enterprises.

A key condition to outsourcing support provision is that there are support organisations to choose from

and, ideally, that they have credible track records of high-quality services. You can decide to pay the support organisations for the support provision directly, or to give the funding to social enterprises who contract support providers themselves. The latter mechanism could strengthen the habit and ability of social enterprises to pay for support, rather than try to do everything in house even if they lack capacity. You may want to choose this way of support if your intention is to strengthen the support organisations and incentivise the establishment of new ones. See the Investment and Contract Readiness Fund (ICRF) example in Section 6.4. for key considerations for partnerships.

And finally, of course, you may decide to combine the two approaches and offer non-financial support directly and by involving (or paying) other providers. Table 8 summarises the possible advantages and disadvantages of outsourcing support, and a detailed discussion of third-party capacity building and investment readiness follows in Chapter 4.

Table 8. Advantages and disadvantages of outsourcing support

Advantages of outsourcing support	Disadvantages of outsourcing support
The funder of the non-financial support can offer a wide range of skills and expertise through the providers, and capacity is multiplied.	The funder cannot directly influence and control the content and quality of non-financial support.
The support-provider segment of the social investment market can be strengthened.	Support may only be short term and focus on specific outcomes (e.g. obtaining one investment).
The social enterprise is enabled to contract the best tailor-made support possible.	There is no or only a limited relationship between the funder and the supported social enterprises.

Challenges of providing non-financial support directly

Although they don't always show it, investees usually appreciate non-financial support a great deal because it brings them benefits that they would not otherwise have access to. However, it also places burdens on them. The investee organisation needs to have the capacity to take advantage of the non-financial support

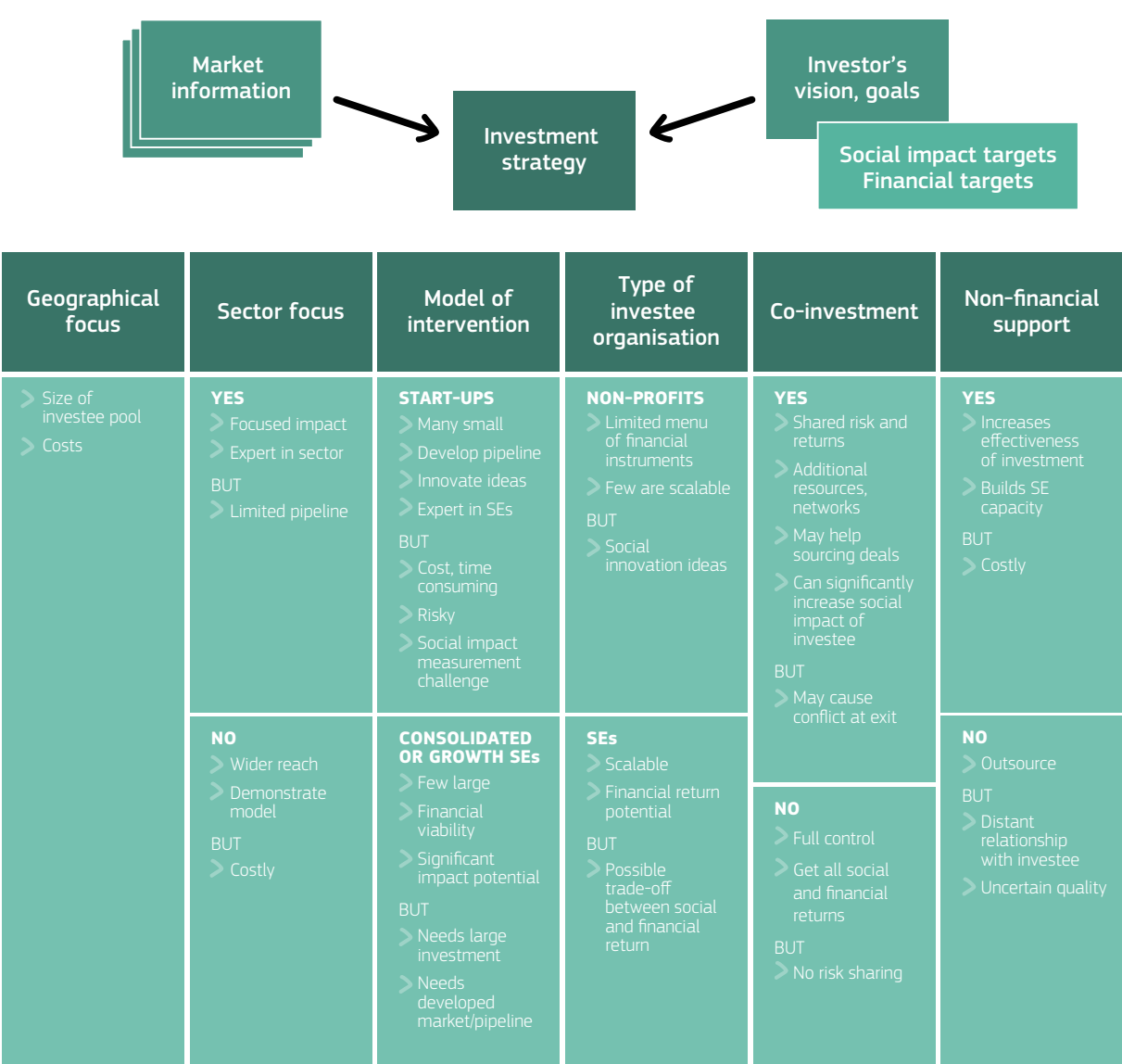
services, such as working with mentors, attending networking events or participating in training sessions. A realistic assessment of the capacities of your target investee(s) will help you decide at which point and at what level non-financial support is feasible. It is an unfortunate reality that many social enterprises (and

intermediaries for that matter) are thinly resourced and a day spent at a course, although valuable, may mean a day lost on a funding application or managing the office.

Another challenge with the non-financial element of the investment strategy is that it is hard to assess its impact on the social enterprise and the resulting social impact. There are indirect ways to calculate the impact of non-financial support using input data

(such as number of volunteer hours) or output data (number of social enterprise staff trained), but often it is only through satisfaction surveys or in-person interviews with investees that investors obtain anecdotal evidence of the impact and value added of their non-financial support. The effectiveness of the support is often only tested when a trained staff member leaves the enterprise: how much knowledge is retained by that person and how much passed on into the corporate memory?

Figure 11. The investment strategy design process



The following Recipe Card of the Greek Social Enterprise Guarantee Facility illustrates a number of design considerations and practices discussed in this chapter.

Greek Social Enterprise Guarantee Facility

Recipe card

From:

Social Enterprise Ecosystem, Greece

Serves:

3 regions: Karditsa (Thessaly), Ioannina (Epirus) and Chania (Crete);
to be extended to all Greek regions in 2018-2019

Prep time:

3 years

Cook time:

1 year



HOW TO MAKE

- 1 Find a number of committed partners in the social enterprise development, finance and impact investment arenas.
- 2 Mobilise the social enterprise community to engage in the process.
- 3 Research the market to identify social enterprise financing needs, gaps and opportunities.
- 4 Sign a MoU with partners, including jointly agreed goals and strategy.
- 5 Develop a loan product for social enterprises.
(Cooperative) bank partner to obtain an EaSI guarantee for a microfinance scheme that could also be used for lending to cooperatives and social enterprises.
- 6 (Cooperative) bank partner to pilot the loan product and gather learning from the microfinance scheme.
- 7 Create a guarantee 'pool' from financial contributions of the cooperative banks involved.
- 8 Identify, train and accredit business development support (BDS) centres.
- 9 Identify social enterprise in need of loans and make them investment ready through BDS programmes.
- 10 Design a national guarantee scheme based on learnings from regional pilots.
- 11 Raise finance from investors for a national guarantee fund.

Notes

The Development Agency and the Cooperative Bank of Karditsa played a key coordinating role in the process and were able to obtain EaSI project funding in two consecutive rounds to establish a guarantee fund (preparatory, strategic, contractual and operational work; building a partnership; and establishing the guarantee fund as a legal entity).

It was important that at the core of the partnership there was a financial institution (the Cooperative Bank of Karditsa

PLAYERS

- > Cooperative Bank of Karditsa (chef)
- > Development Agency of Karditsa (sous-chef)
- > Cooperative banks in other regions
- > Social enterprises and cooperatives interested in social finance
- > Organisations (regional development agencies) interested in becoming BDS centres
- > Social entrepreneurship competence centre

INGREDIENTS

- > Integrated local social ecosystem in the partners' areas
- > Experience and practice in social finance
- > Financing from the EIF's EaSI guarantee facility
- > Further financial contribution from local cooperative banks
- > Start-up, business development and social impact management support services (investment readiness)
- > Long-term commitment of the partners manifested in a MoU
- > Common values and shared vision among partners
- > Social entrepreneurial spirit and tradition among partners
- > Cooperation with universities and research centres
- > Links to social impact investors

in this case) and a business development organisation (the Development Agency of Karditsa), which both had an in-depth understanding of the financial needs of the social economy and social enterprises, as well as small business lending.

Social enterprises need investment-readiness support in order to become creditworthy. Providers of such support must offer quality services assured by accreditation.

The specific example of City Bridge Trust can be a good illustration of the strategy design process and the key considerations in Figure 11. It shows how different elements of an investment strategy can be combined and what might motivate the decisions made about each one.

EXAMPLE: INVESTMENT STRATEGY CITY OF LONDON CORPORATION SOCIAL INVESTMENT FUND

The City of London Corporation launched its GBP 20 million Social Investment Fund in 2012 in order to ‘provide loan finance, quasi-equity and equity that provide development and risk capital to organisations working towards charitable ends or with social purpose’ and to contribute to the development of the social investment market ⁽⁷⁸⁾. The Fund invests both directly in organisations and indirectly through other funds. In line with the Corporation’s mandate to build the social investment market in the UK, the Fund invests mostly in London and the UK, though 10 % of its resources are allocated to international investments. In terms of risk appetite, each individual investment must offer a minimum return of 2 %. The Fund aims for capital preservation and is seeking an overall return of 2.7 %, required due to the source of funding. This in turn has implications regarding the size and types of investments the Fund can make; they are typically no smaller than GBP 100 000 and finance well-established organisations that are able to absorb and repay finance. The Fund does not provide non-financial support to its investees.

In its first 5 years, the Fund achieved an internal rate of return of 4.7 % and approved investment totalling GBP 12 996 228 ⁽⁷⁹⁾. It was challenging and took time to deploy funds due to an initial lack of investment opportunities. In the next 5 years, the Social Investment Fund will continue to seek

investment opportunities according to its current investment criteria. However, due to the scarcity of suitable opportunities, it will continuously review its criteria and may consider smaller investments as well as venture capital proposals. It will also consider new areas of investment, such as housing for teachers. The Fund will work more closely with City Bridge Trust’s grantmaking operations whose grantees could be referred to social investment.

The Fund will also build on an investment-readiness programme, which was developed 2 years after the launch of the Social Investment Fund, in recognition of the gap between grant finance available for organisations and the requirements for those who sought to secure social investment. The Stepping Stones Fund, co-financed and supported by UBS Bank, provides organisations with grants that enable them to explore social investment as a financing option and build their capacity. The provision of non-financial support has therefore become possible to potential future investees, thanks to an external (but close) partner. The success and positive impact of the Stepping Stones Fund was recognised in 2018 when it won the Charity Times’ Award for Best Social Investment Initiative.

Your summary questions for Chapter 3:

- What are the key elements of your investment strategy?
- What possible ways do you have of operationalising your strategy?
- What are the biggest challenges that you expect to face when implementing your strategy?
- What trade-offs do you expect to make?
- Do you want to go it alone or in partnership with others?



78 City Bridge Trust (n.d.b).
79 City Bridge Trust (n.d.b).

Chapter 4

Build your intervention strategy

*Capacity-building support:
Addressing the lack of investable social enterprises*

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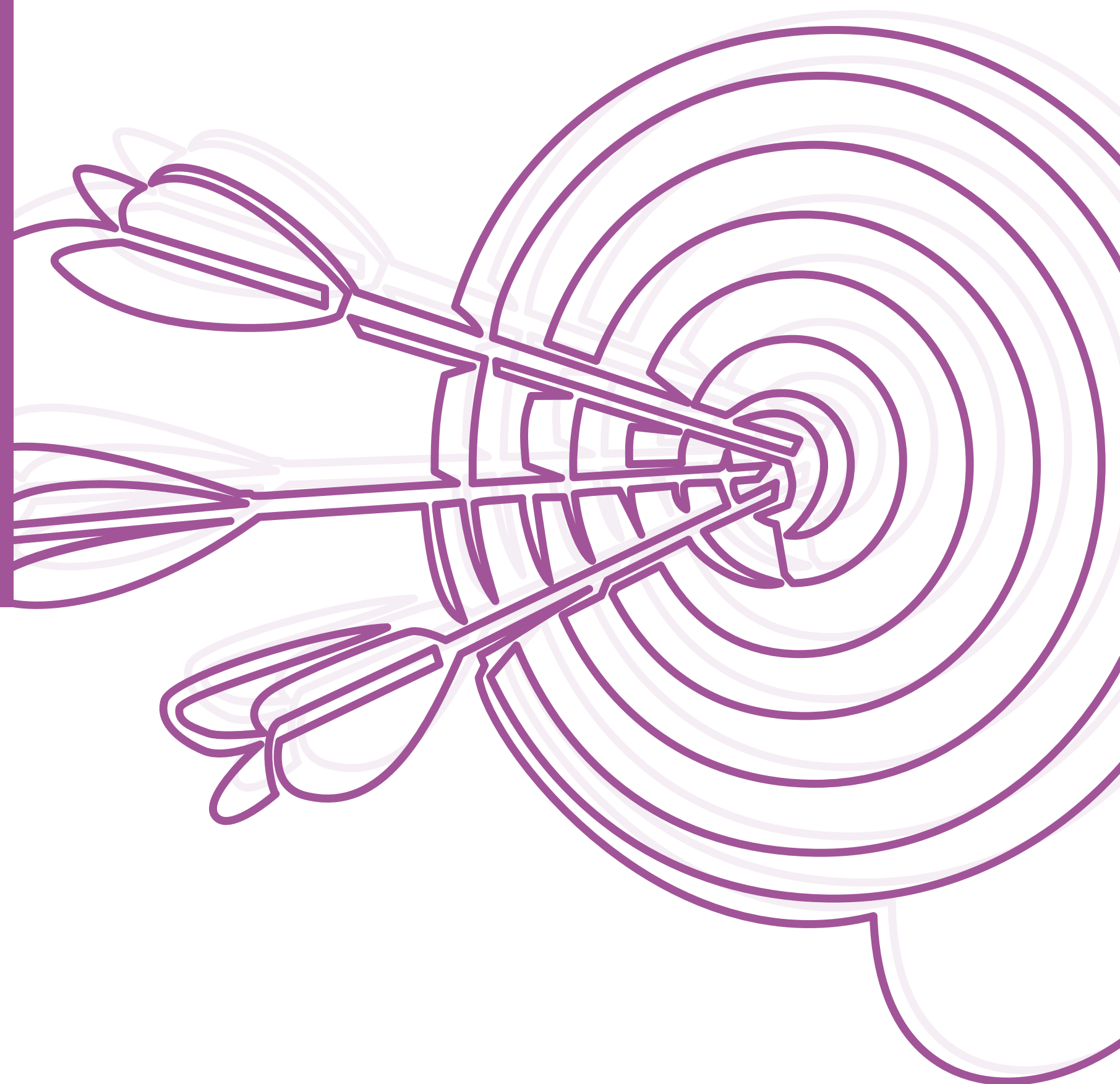
Learning objectives

On completion of this chapter, you should be able to:

- understand the possible context for your social investment market;
- consider the key aspects of building an effective demand-side support programme;
- decide your focus on the demand and/or supply side;
- decide what type of support organisation you want to be based on your objectives, resources and skills;
- explore intervention models and methodologies for demand-side support;
- understand and weigh up investment-readiness programmes;
- consider the role of partnerships and collaboration in your intervention.

At this point, you should ideally have done the following:

- decided that you are an intermediary;
- identified your vision and main objectives;
- recognised your potential value added;
- assessed your risks;
- identified your potential partners.



In Chapters 1 and 3, a number of barriers to social investment from the social investor's perspective were considered. In this chapter, the focus will be on one key barrier: the perceived lack of viable enterprise models to invest in.

4.1. Goals of support provision

This chapter is about your intervention model, specifically if you decided that you would like to support the demand side of the social finance market and build investee capacity, or if you would like to offer expertise to facilitate financing deals by working with both the supply and the demand sides.

Your market assessment will have given you an indication of the stage of development of the market in which you would like to operate, for example, whether it is a nascent or mature market. You will also have learnt what the key barriers are on the demand side in terms of investment opportunities. Figure 12 summarises what the general goals can be for support provision in young and mature social investment markets.

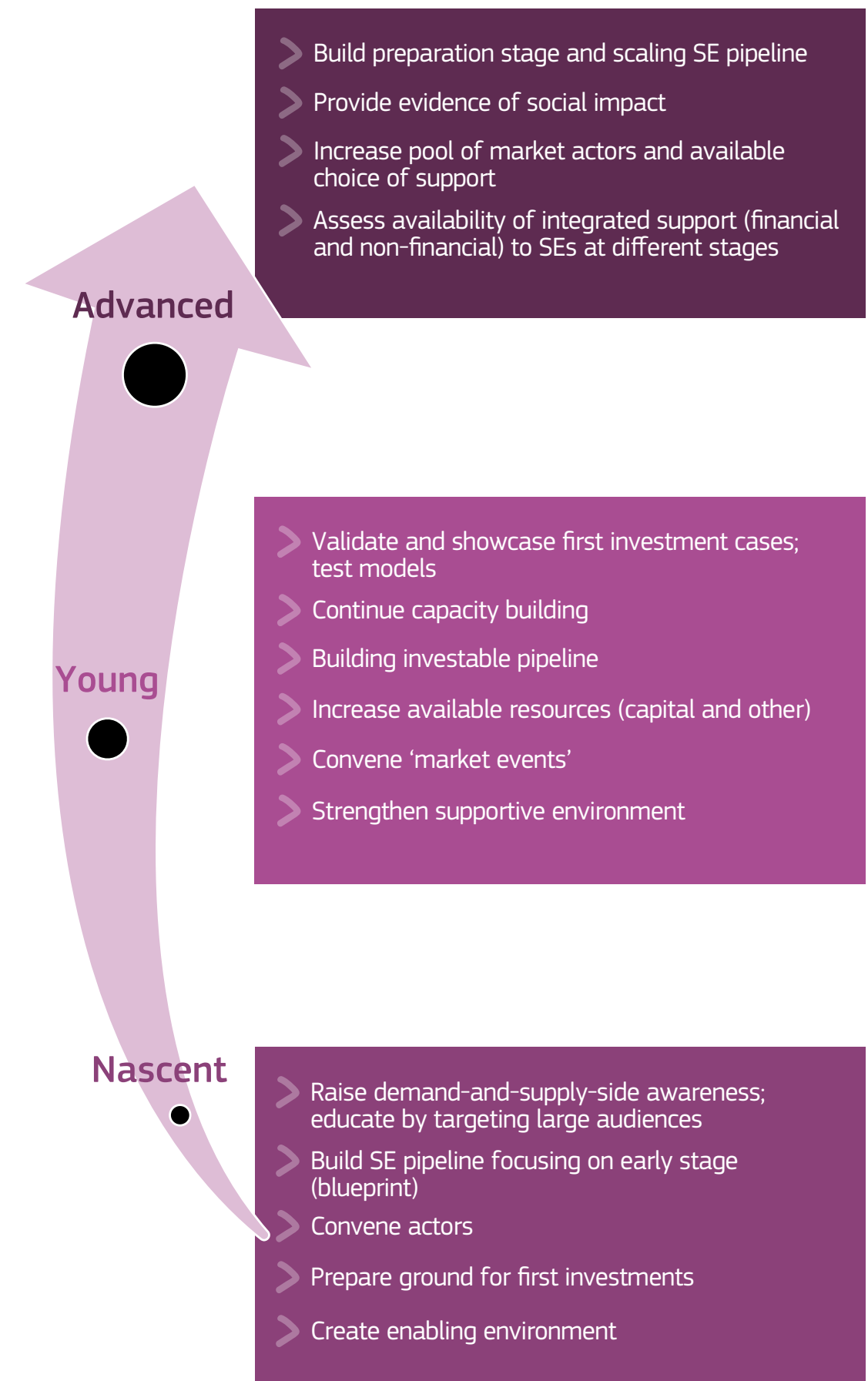
Nascent markets require a lot of awareness raising and educational effort, targeting all major actors in the market. New participants entering the market need to become aware of social enterprise models, as well as of each other and the potential benefits they can reap and contributions they can make. The focus of support provision is on early-stage social enterprises whilst also showcasing the first successful models, which can become the first investment cases – the ‘low-hanging fruit’. An important aspect of such a market is that many enterprises are unfamiliar with the term ‘social enterprise’ and, as such, do not automatically think of themselves as social enterprises and may therefore exclude themselves from support measures. People

working in nascent markets must be willing to adapt and to change tack to meet the needs of enterprises rather than provide what they want to.

Young social investment markets need to continue building an enabling environment and convening actors, but with a more advanced agenda: to showcase and validate an increasing number of pioneer investments. Continued capacity building of investees and investors is recommended, and an increased resource pool is essential to meet growing demand for capital. Our experience is that showcasing successful first investments – as well as showing what can go wrong – leads to more enterprises seeking finance.

Advanced markets can rely on a larger pool of resources, an increased number of willing actors and thus either a wider choice of support or the introduction of liquidity into the market by developing secondary markets. Capacity building could typically focus on the preparation of scaling social enterprises, providing evidence of their social impact and the offer and use of tailored financial investment.

Figure 12. Goals of support provision at different stages of the social investment market



Becoming a support organisation or an intermediary may involve taking on a variety of roles, as represented in Figure 13. The general objectives of an intermediary's interventions are fundamentally to:

- generate a constant flow of investable social enterprises (pipeline);
- build the capacity of social enterprises in a number of areas;
- facilitate communication and dealmaking between various stakeholders in the market;
- raise awareness: with developments in technology, a growing number of intermediaries are developing electronic platforms to facilitate deal awareness and showcase enterprises;
- mould, protect and increase the effectiveness of the investments;
- contribute to a better functioning social finance ecosystem.

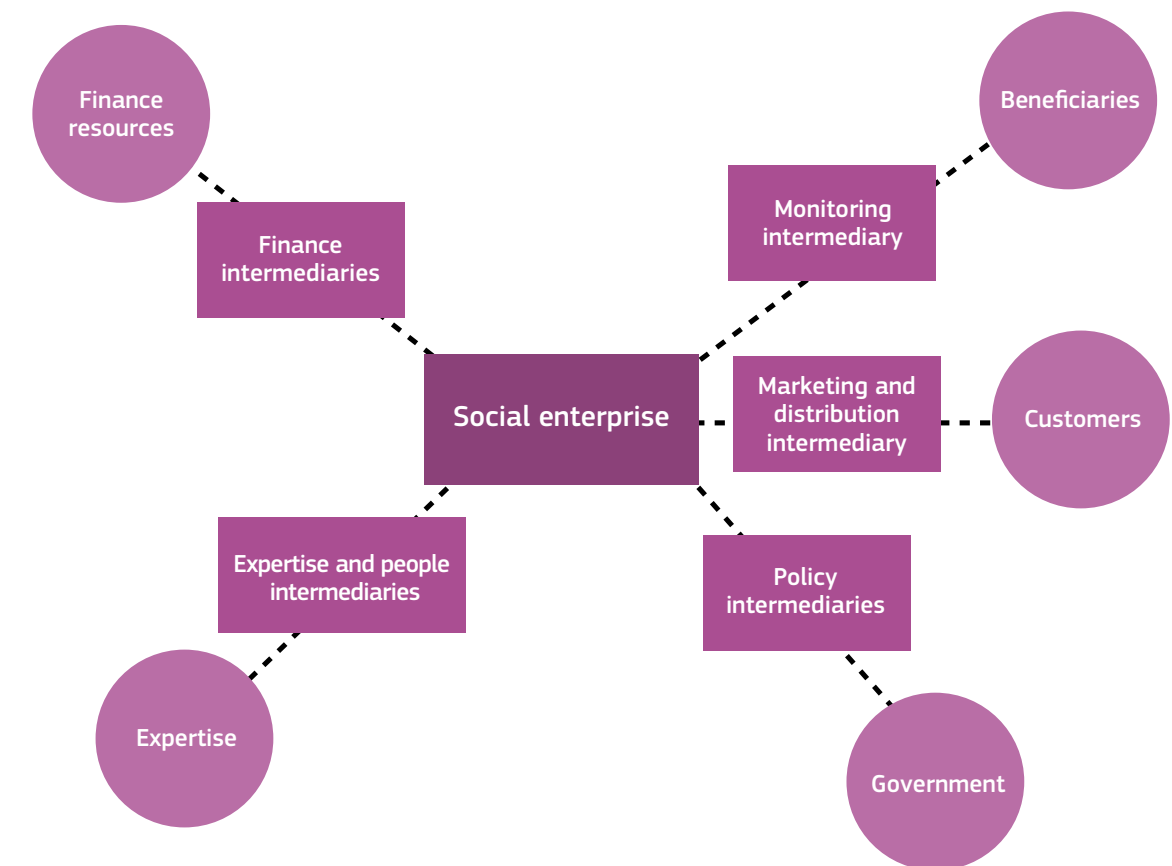
Intermediaries may be active in a number of areas where connections need to be made and resource flow needs to be facilitated to benefit the social enterprise. They may play a role in the

enterprise's key relationships – with beneficiaries, with customers and vis-à-vis experts. Marketing and distribution intermediaries can include various online sales platforms or public procurement/commissioning advisors. Expertise intermediaries can be networks, investment-readiness providers or consultants, while beneficiary-facing intermediaries (i.e. monitoring intermediaries) can include specialised measurement consultancies. Policy intermediaries may include umbrella bodies of social enterprises or researchers that facilitate the flow of information between government and social enterprises. While intermediaries may start out by focusing on one aspect or relationship, they usually end up supporting social enterprises in other relationships too. The example of ClearlySo, which has been referred to as Europe's leading impact investment bank ⁽⁸⁰⁾, illustrates this well: the company runs investment-readiness programmes to connect social enterprises not only with financing options, but also with expertise. See Chapter 7 for more detail on ClearlySo.

Another increasingly important role for intermediation in the fintech age is the provision of platforms to reduce information asymmetries between investors and enterprises seeking funds in both local and global markets.

Figure 13. The role of intermediaries

Source: Adapted from Shanmugalingam et al. (2011)



Based on your market assessment, you should also have identified what non-financial support and capacity building is available to social enterprises and social investors and what may be missing. You know where the knowledge gaps are and who else is active in the market. From this information, you have developed your vision, decided where you would like to position yourself in the market, identified your niche and potential value added and defined your goals in terms of impact. You can use criteria similar to those of financial investors, as detailed below, to design your intervention strategy.

- What is your intervention focus?
 - Do you have a geographical or sector focus?
- What types of social enterprise will you support?

- What is your model of intervention?
 - Will you support the demand or supply side?
- Will you collaborate with others?

An additional question you need to answer after looking at the above list is whether you are committed for the long term. Capacity-building support and consultancy services can be offered long term, indefinitely or as one-off support to address a specific issue. **Which one of these are you interested in and able to provide? Are you a consultant, a training company or an incubator? Are there other players that meet the demand for capacity building, knowledge and advice? Should you enter the market in cooperation or in competition?**

4.2. Providers of capacity-building support and advisory services

In the previous chapters, a lot was made of organisations that provide support services to social enterprises. Indeed, as explained in Chapter 3, it is often the investor themselves that chooses to offer non-financial support to investees in order to minimise risk and maximise the social (and possibly financial) return. Such support is usually limited to those enterprises within the investor's portfolio or on the point of entering it.

Support providers are third party organisations that can act in cooperation with or independently of investors. They may offer their programmes or services to social enterprises, investors or other actors, including fellow intermediaries, in their efforts to develop the market. They cover a range of nomenclatures, illustrated in Table 9 below. When deciding what role you want to play and what type of support organisation you would like to become, it is very important that you assess what skills and experience it takes to deliver the support you intend to offer, and how those compare to skills that you have in house or are able to obtain externally, and how long they may be available to you.

Incubators are capacity builders that offer their services to start-up and early-stage social enterprises to develop and test their business models.

Accelerators focus on successful social enterprises who need capacity-building and possibly financial help to grow and scale.

A third category has joined the lexicon in recent times: **campuses** are neither incubators nor accelerators because they do not invest, but they help start-ups with everything else. The largest campus in the world is Station F in Paris, although this serves a wide spectrum of enterprises beyond social enterprises ⁽⁸¹⁾.

Intermediaries connect social enterprises with suppliers of finance, expertise, beneficiaries and customers. Non-financial intermediaries focus on matchmaking, while financial intermediaries play the role of investors themselves by setting up their own funds or financing facilities.

Platforms and knowledge hubs are a relatively new phenomenon. They have been developed to create greater transparency amongst actors, to showcase what is being done and to connect investors with projects as well as with each other. Platforms can also help social enterprises with investors. In March 2018, a group of US venture capitalists working for increased diversity launched the Founders for Change Diverse Investors List, which allows founders to search funds by investment stage, sector and background ⁽⁸²⁾.

Table 9. Social enterprise and social finance support providers

Type	Features	What does it take to become one?
Support organisation Provides mostly non-financial support to social enterprises; this generic term also includes the categories below	• May target social enterprises of different levels of development and size • Usually supports few social enterprises at a given moment in time • Support can take different forms and can often be long term • Support is given for varying durations • Often runs investment-readiness programmes • If it offers funding, it is likely to be a small amount	• Business planning and management skills and tools • Financial modelling skills • Investment experience and network • Social impact measurement and methodology experience • Organisational development experience • Network of mentors and coaches • Capacity to accompany social enterprises for the long term • Funding for its own organisation as well as for the social enterprises it supports
Incubator Helps start-up and early-stage (social) enterprises develop	• Focuses on new and start-up businesses • Provides training, mentoring and often office space • Offers support only for the start-up phase (short term) • May provide some seed funding	• Business planning and strategy skills and tools • Financial modelling skills • Social impact measurement and methodology experience • Network of mentors and coaches • Capacity to deal with a large number of social enterprises • Funding for its own organisation as well as for the social enterprises it supports • Premises
Accelerator Helps existing businesses accelerate their growth	• Focuses on existing social enterprises • Provides a variety of support, including mentoring • May offer seed capital in exchange for part ownership • May connect portfolio to impact investors	• Business strategy and management skills and tools • Financial modelling skills • Investment experience • Social impact measurement and methodology experience • Mentor and investor network • Effective ability to identify promising social enterprises • Funding for its own organisation as well as for the social enterprises it supports

81 Station F (2019).
82 www.foundersforchange.org

Campus Provides co-working space to start-ups where entrepreneurs can interact with other entrepreneurs	• Charges a desk fee per month • Domestic and international start-up programmes • Open access to similar-stage entrepreneurs • Event and maker spaces • May have restaurant, kitchen, café and bar facilities • May have leisure facilities • May offer programmes such as an immersive ‘founders fellowship programme’ or a free 1-year programme for entrepreneurs who weren’t ‘born into privilege’	• An active community where mutual learning and help are expected • Access to workshops and perks (a package of deals needed by founders, e.g. Airbnb credits, cloud hosting, gym memberships; start-ups may also offer perks to other residents) • Hosts venture capital meetings for social enterprises, but does not provide finance • Values and philosophy shared amongst members • Facilitation of networking and cross-fertilisation • A significant initial capital investment in the campus itself
Intermediary Non-financial intermediary Connects social enterprises with suppliers of finance, expertise, beneficiaries and customers	• Provides tailor-made services to social enterprises and/or investors, including matchmaking • Helps construct and implement the investment deal • Receives a fee for its services	• Financial modelling skills • Investment experience • Large network in a number of investor segments • Good connections in the social enterprise sector • Good system of scouting out investable investees • Investment-readiness programme, if necessary
Financial intermediary Makes investments in social enterprises on behalf of other investors, who do not wish to invest directly	• Invests in social enterprises on behalf of other investors • Manages funds or other financial vehicles • Sustains itself by earning fees from investors and interest on investments	• All of the points in ‘non-financial intermediary’, plus available finance

EXAMPLE: PLATFORMS FOR RAISING IMPACT CAPITAL: SOCIAL STOCK EXCHANGES

Social stock exchanges are information and trading platforms that list companies with social and entrepreneurial goals. The essential purpose of social stock exchanges is that investors can use them to find a social business with a mission that matches their preferences and buy shares in them ⁽⁸³⁾ thereby helping to connect supply and demand. This enables social enterprises to access capital that would not have been available to them before. Several countries have opened their own social stock exchanges, starting in 2003 in São Paulo, Brazil. All social stock exchanges are different; some act only as an information platform for investors and the general public (e.g. in the UK, where the social stock exchanges has now set up a licensing company in order to spread the model internationally) ⁽⁸⁴⁾, while others are closer to a fully-fledged stock exchange as they facilitate investments (e.g. Canada’s Social Venture Connexion) ⁽⁸⁵⁾, which now also allows accredited retail investors to invest in debt and equity instruments, using crowdfunding and direct placement). ImpactExchange claims to be the world’s first social stock exchange dedicated to connecting impact enterprises with capital that reflects their values. It was established by the Mauritius Stock Exchange and IIX ⁽⁸⁶⁾. In another region, the Global Islamic Finance and Impact Investing Platform,

led by the Islamic Development Bank and UN Development Programme’s Istanbul International Center for Private Sector in Development, serves as a knowledge hub for promoting peer learning and experience sharing, as well as a marketplace for deal sourcing and matchmaking ⁽⁸⁷⁾.

Social stock exchanges continue to face a number of challenges, which have limited their up-take: the accreditation of intermediaries and valuation of listed social businesses, especially a consistent approach to calculating social returns and sustainable business models, are some of the most significant. In Australia, there has been concern that the mobilisation of private capital in this way leads to governments taking less responsibility for dealing with social and environmental problems that will not be addressed through market mechanisms ⁽⁸⁸⁾. In the meantime, some social stock exchanges operate similarly to crowdfunding platforms by simply matching social businesses with investors. Another question may be whether social stock exchanges can become relevant as global or wholesale investment platforms given the often local and community-based nature of social enterprises and social investors.

83 Chhichhia (2015).

84 Impact Investment Network (n.d.).

85 SVX (2019).

86 Impact Exchange (2019).

87 Global Islamic Finance and Impact Investing Platform (2019).

88 Logue (2015).

Social investment marketplaces, which can be closed or open platforms, have struggled to gain traction in the United States (US). At the beginning of 2018, the ImpactUs marketplace closed just 8 months after it was launched. By making it easier for investors and enterprises to find each other, the Kickstarter-like platform was set to spur major ‘new deal flow’. ImpactUs took on a screening role, defining what was on offer and laying out minimum investment levels and expected returns. It provided an approachable website, online transaction processing and back-office support, and was particularly keen to work with enterprises wanting to reach investors that were willing to invest for below-market financial returns but with evident social and/or environmental returns. The platform was founded by community development financial institutions in the US that have a track record of success and consistent, modest financial but strong social returns on investment, which de-risks investing in social projects for investors. The platform received significant philanthropic funding (hundreds of thousands of dollars) from leading foundations including the MacArthur, Ford and Kellogg Foundations as well as the Open Road Alliance. It is understood that the platform failed to attract sufficient private capital to align with the philanthropic funding.

But ImpactUs was just the latest in a string of failures in the US. In 2009, Mission Markets raised and spent some USD 4 million in developing an environmental deal pipeline before closing. Enable Impact was initially launched as a matchmaking site before becoming a fee-based investment service. Even then, it was unable to fund enough deals to build a sustainable business. This demonstrates that it is not just small support organisations that can find it difficult to be sustainable. However, it may not all be about finance. It is argued by some that ‘go-it-alone’ platforms fail to gather enough deals and investors, and collective approaches are more likely to be successful ⁽⁸⁹⁾.

In less developed markets, only a few such support organisations tend to exist, and they may play a combination of these roles. A good example is Oksigen in Belgium, which provides integrated support for social enterprises (see Section 4.4.1.). In more advanced social investment markets, there is often a whole industry – including the entire range of support agencies – that may focus on certain types of social enterprises or specific sectors, or that offer a complete range of support and services to the whole social enterprise sector. Some may focus only on investors and offer ‘investor-readiness’ advice, while others connect investors with potential investees and are the matchmakers in the system.

According to Global Social Entrepreneurship Network (GSEN), support organisations are a critical link in the enterprise development chain, as they provide the specialist support that social entrepreneurs need at the start-up stage to transform their ideas into reality. Reviewing the above types of support organisations and what it takes to add value through them should provide input into your decision-making process in terms of what the best fit would be for you. Notably, where can you add value? Experience tells us that it is very hard to become a credible support organisation without prior experience in (social) enterprise development and involvement with social enterprises on the ground. Social enterprises often prefer to work with their peers and with people who understand the triple-bottom-line approach rather than commercial consultants or large accountancy firms. While barriers to entry into the support and consultancy business may be low, becoming a sustainable support organisation can be very challenging if that is all your business model is based on. In Chapter 5, we will be returning to the issue of financial sustainability of intermediaries and how philanthropic supporters might play a role there.

4.3. Intervention focus

Similar to financial investors, support providers may wish to focus on a specific geography or sector if they have identified a capacity gap, have specialised knowledge of the area or have a particular emotional or personal motivation. Capacity-building support can be very contextual in nature, so it is often local and is most effective if provided in the local language and with an understanding of the prevailing legal framework. If markets are small, support organisations may decide to set up a regional model, which is more cost effective from their point of view and may provide learning benefits for a larger number of social enterprises. A case in point is NESsT; it has developed a Central European portfolio and used learning in the pioneer countries (e.g. Hungary in 2001) to refine the model in newer ones (e.g. Romania in 2007).

Sector considerations are fairly similar to those of the financial investor:

- **What are your goals?**
- **Do you want to build the capacity and perhaps the investment readiness of a specific sector, for example, healthcare? Or do you want to demonstrate the viability of the social enterprise model?**
- **Do you have the expertise to work in a specific sector? If not, are you able to develop or acquire such expertise?**
- **Are there enough social enterprises to work with if you focus on one or a few sectors only?**
- **Can you fund your support if you have a sector focus?**

Your answers to these questions could determine your intervention model and the composition of your future portfolio.

4.4. Types of social enterprise supported

4.4.1. What stage of development should you focus on?

If you are a support organisation, you may target your support to certain types of social enterprises or offer it to everyone. The majority of support organisations deal with start-ups and early-stage enterprises, because that is where the need tends to be the greatest and because they want to generate a continuous and large pipeline of potential investees. A lack of investable propositions represents a gap even in developed social investment markets, so early-stage support is a must. This is reflected in global surveys as well: 73 %

of GSEN members (defined as support organisations) target idea-stage social enterprises, while 93 % have targeted the prototype stage and only 8 % focused on growth stage in 2017 ⁽⁹⁰⁾. This is in strong contrast to data on the impact investment industry, where 78 % of the global investments in emerging markets targeted growth-stage companies in 2012 ⁽⁹¹⁾. By the nature of their requirement for financial as well as social returns, impact investors’ single largest challenge is the shortage of high-quality investment opportunities

89 Scholz et al. (2018).

90 The ‘idea stage’ is defined as conceiving and developing an idea to solve a social problem. Prototype stage is defined as developing, piloting and testing the idea/the entrepreneurial model. Source: Global Social Entrepreneurship Network (2017).

91 Growth stage is defined here as when the company has positive EBITDA (earnings before interest, tax, depreciation and amortization) and is scaling output. Source: Saltuk et al. (2013).

with track records ⁽⁹²⁾. Rather than adapt their return criteria, these investors tend to wait for other players in the market (government or support organisations) to address this mismatch.

Accelerators and intermediaries that wish to focus on scaling enterprises need a different set of skills to those used for start-up support. They need to be able to work on growth strategies and financial models and mobilise a pool of experts that can offer specialised advice. This group of support organisations needs to have a wide network of potential investors, as quite often they will play the role of the dealmaker as well. Accelerators usually work with far fewer social enterprises than support organisations focusing on early-stage enterprises. They have a sophisticated selection and due diligence process in order to identify

the most promising enterprises and offer them intense and often long-term support for the scaling phase. This is a resource-intensive approach, which requires a stable and sustainable support model from the support organisation as well.

In many European social finance ecosystems, intervention is necessary at all stages of the investment pipeline, therefore support organisations decide to offer a continuum of services to potential investees. A case in point is Oksigen, which has developed a number of facilities (and companies), thus providing better support to social enterprises and strengthening their own sustainability as well.

EXAMPLE: OKSIGEN'S INTEGRATED SUPPORT PACKAGE FOR SOCIAL ENTERPRISES

Oksigen is a group of companies in Belgium that considers itself an ecosystem of support organisations with a shared mission that offers a broad range of capacity and scale-up services to organisations targeting social impact. Oksigen Lab conducts research and offers coaching to social enterprises, focusing on idea development and business planning. Oksigen Accelerator makes coaching more accessible for social enterprises and offers an ambassador and professional network. SI² Fund is the impact investment fund in the group, which invests in social enterprises offering growth capital. Finally, iPropeller is the group's consultancy in social business innovation and shared value. These companies, which form the Oksigen group, could be considered as the stages of development of a social enterprise: an enterprise enters at the

idea development stage and may come out as a fully invested social business at the other. This proposition can be very attractive to organisations or individuals looking for support. The model can also be very efficient for Oksigen, as organisations moving through the different stages create the pipeline for the next phase. Oksigen identified the gaps in the Belgian social enterprise and social investment market and constructed this model in response. It is a model that has also been continuously improved; in their pilot project, for example, Oksigen launched Oksigen Crowd for donation/reward crowdfunding, which is now being integrated into a larger crowdfunding platform for social impact in partnership with Bank Degroef Petercam and several Belgian foundations.

4.4.2. Finding and selecting social enterprises for support

Support organisations often operate with an open call for proposals to find the social enterprises they want to work with, especially for early-stage support. This ensures that they have a large pool of applicants to choose from and can focus their resources on organisations that best meet their criteria. If you do not have the resources or network to explore individual targets (in other words, to 'cherry-pick'), open calls may be the way to go. Online tools and social media make this relatively cost effective. Before deciding to announce your call, however, you may need to consider the possible consequences. ***What if you get inundated with interested applications?*** If the opposite happens, ***how will you deal with lack of interest?*** Defining your target audience and communicating your message clearly to them is of key importance; ***are you targeting idea-stage or growth-stage enterprises?*** Working with partner organisations may offer different ways to promote your offer, as well as making sure that you have explored all possible dissemination channels.

Assessing the applicants and selecting those you would like to work with also requires a clear set of criteria and a selection system. Depending on the intervention model you opt for (as covered in the following section), you may want to select a large number of organisations or reduce the numbers from the beginning. The former works very well if you are planning to run a group support programme, while for a one-on-one approach you will need to be very selective. Some organisations, for example NESsT and UnLtd, used to start their tailor-made capacity-building programmes with a large pool of organisations, but reduce their numbers dramatically in the first round. The feasibility study stage at NESsT used to rule out organisations whose social enterprise idea seemed unfeasible after a first basic business assessment.

A simple selection system can rest on the following criteria (besides the formal eligibility):

- strongest business case
- most experienced team
- biggest impact potential
- your potential to add value.

There are a number of ways to assess the interest and potential of social enterprise applicants. You can base your process on written applications or combine those with candidate interviews. You could also create a scoring system in which the above listed elements each carry an assigned weight. This would allow you to calculate a score for each social enterprise and compare them. Experience suggests that face-to-face selection can be crucial, if only to establish that the enterprise understands the extent of the time commitment needed and so reduces the likelihood of dropout.

You may not have the resources to take on every applicant you would like to. It is up to you to decide what to do with the organisations that have not been selected. ***Have you got some additional resource that you can dedicate to them so that all of that potential is not lost? Are there other support organisations you can signpost them to for further development? Or can you provide them with constructive feedback, so that they can improve their enterprise model and apply again in a possible next round?***

4.5. Models of intervention

A number of models exist for the provision of capacity-building support and advisory services, but you can also design your own model using the framework in Figure 14.

You will need to ask yourself the following questions.

- Do you wish to serve the demand side or the supply side, or possibly both?
- What approach and methodology do you want to use?
- Do you intend to provide short-term or long-term support?
- Will you provide funding? Will you provide the support yourself or jointly with someone else?
- Will you play a matchmaking role?
- If there is a need for market-building, will you be able/willing to assume that role and do you have the resources to do so?

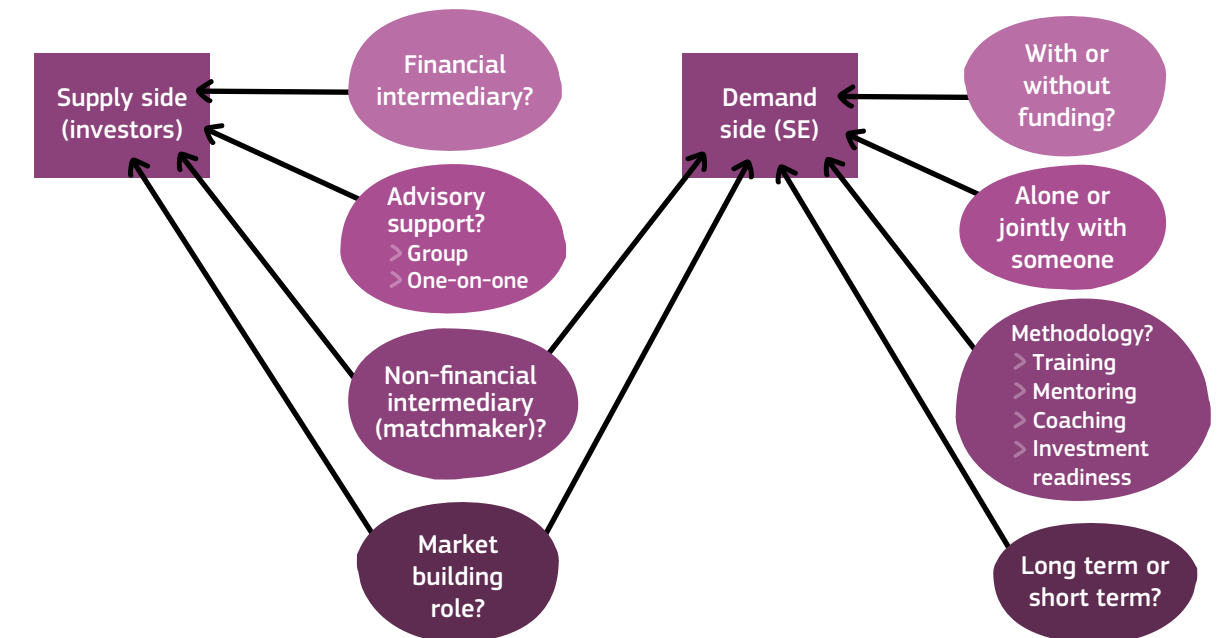
4.5.1. Demand-side support

From the perspective of the social investment market, the question that support organisations try to answer is: How do we create an investable social enterprise pipeline and be sustainable ourselves? Of course, support organisations have a wider mission than just to 'work for social investors', since their primary goal is to develop a social enterprise sector that uses entrepreneurial approaches to provide sustainable solutions to social problems. But finance is an indispensable ingredient in the resource mix and investment-readiness support is key to unlocking desperately needed capital. We discuss investment-readiness programmes in more detail in Section 4.5.1.4.

How can you create an (investable) social enterprise pipeline out of nothing? The answer is simply: you can't. Social investment markets go through development stages as well, and you can't 'leapfrog' to more developed stages without laying the foundations first. Good practice examples can help prepare the ground faster or with fewer mistakes (although you often learn more from other people's mistakes or

misfortune), and they will encourage replication, but the fundamentals can't be overlooked: that includes the creation and development of actors in the market. Of course, this is not your only task, but it can be an interesting challenge to take on if you have identified yourself as a market-builder. If your market assessment suggests that the foundations are missing, you need to start working on those or find and support partners that are already doing so. Financial investors in search of investment opportunities may find it beneficial to support such endeavours, so reaching out and partnering with them could be a logical step. Different kinds and levels of support are required at different stages of market development, just as different support is required by individual social enterprises at different stages of their life cycle. As a market develops, its segments tend to become more populated and, ideally, different types of support at all levels and at all times will become available.

Figure 14. Pointers for designing a non-financial support framework



4.5.1.1. Intervention methodologies

Group support: Training and skill building

One possible intervention methodology may be group support. This is especially cost effective if the demand for capacity building exceeds the supply and individualised support is not feasible for everyone. Group training, competitions or events may be a good way to pre-select social enterprises for further one-on-one models. Group support may also be the best way to go if your objective is the transmission of information, sharing of knowledge or building of skills. Schools of social entrepreneurship or various training programmes are examples of this approach. Except for social enterprise management degrees, these programmes tend to be short term, are sometimes theoretical in nature and can lack follow-up. More practical and focused group-based intervention examples exist as well, where enhancing collaboration and networking among participants is one of the key objectives. However, while group-oriented

interventions have the potential to work with a large number of social enterprises, they often don't allow long-term, in-depth work with individual businesses.

Award and competition schemes have become widespread and popular. If paired with capacity-building elements, they can be an effective way to build capacity, select social enterprises with impact and growth potential and build an investment pipeline. Awards offer an added incentive for participating organisations and help keep the process within a reasonable timeframe, for example, by requiring business plans to be submitted by a certain date. Winners may be offered funding, training opportunities and/or one-on-one support.

EXAMPLE: UNLTD'S COMPETITIVE AWARDS

UnLtd in the UK has run a number of award schemes in the past and launched its latest scheme in 2018. Past awards ⁽⁹³⁾ have focused on different target groups (e.g. young entrepreneurs or universities) or geographical areas (e.g. London's East End or the borough of Tower Hamlets). Through a competitive process, UnLtd offered support to social entrepreneurs at various stages of their journey. Perhaps the best known of their investment-readiness programmes is the Big Venture Challenge (BVC) ⁽⁹⁴⁾, which was an award scheme that ran for 4 years starting in 2013. It was a 12-month intensive programme designed to help selected entrepreneurs with clear potential to scale win investment (debt or equity)

of GBP 50 000 to GBP 500 000. This involved working with entrepreneurs on growth business models and strategic connections to investors as well as providing match funding to complement the private investment raised. BVC was also a matchmaking programme, as it constantly appealed to private investors to invest in social enterprises with potential. The programme came to an end in 2016 when the underlying Lottery funding ended. Over its lifetime, BVC supported 120 social entrepreneurs to scale, 74 of whom went on to raise investment totalling GBP 13 million. UnLtd has continued to develop a range of award programmes as an effective way to identify promising social enterprises with impact potential.

EXAMPLE: SOCIAL IMPACT LAB START-UP SUPPORT PROGRAMME GIVES CONCENTRATED, ONE-TO-ONE SUPPORT

As explained on its website, 'Social Impact has focused on supporting social start-ups that use their ideas to solve social challenges in an entrepreneurial way. Social start-ups are given grants that fund up to 8 months of professional consultancy, coaching, workshops and co-working workplaces. Social Impact also offers foundation programmes for special target groups' ⁽⁹⁵⁾. Though Social Impact Lab's start-up support is a relatively short programme, it offers a range of support services and may lead the social organisation to use other Social Impact services, such as its crowdfunding and finance support (Social Impact Finance) or its professionalisation and scaling consultancy (Social Impact Consult).

Social Impact works successfully with partners and funders, thereby making start-up support possible at both local and regional levels. Its support also targets special beneficiary groups. The Impact Lab, for example, is run in Berlin, Hamburg, Leipzig and other German cities, while some of the start-up programmes focus on youth (Jungstarter) or immigrants (Lotsendienst). In this way, the organisation leverages smaller regional or local funding for its activities and uses its knowledge and expertise in different ways. Social Impact has also managed to expand to other countries using its model, with Labs being set up in Austria and Switzerland.

One-on-one support: Mentoring and coaching

One-on-one support is unarguably the most effective approach if the objective is to support enterprise development from start to finish and to work closely with a few organisations rather than more superficially with a broad range of them. This may be the only approach if the support programme aims to accompany social enterprises from the start-up to scaling phase. One-on-one support often shapes up in a portfolio approach, whereby the support organisation keeps a small portfolio of investees together and offers some of its benefits to them as a group. This approach is closest to that of financial investors, who create portfolios to spread the risk among social enterprises with varying return potential. The individualised approach is reflected in the menu of tools and instruments used by such investors as well: coaching, mentoring and

tailor-made capacity building dominate. Even the use of standard tools and templates in this context is usually accompanied by personalised advice. Support organisations also have a larger stake in their portfolio enterprises that are supported one-on-one: literally, if they invested capital in them (for example, accelerators), but also on a more personal level, through the investment of time, human resource and social capital. One-on-one support tends to be longer term than group support and allows for a closer relationship to be developed between the support organisation and the social enterprise.

DOs and DON'Ts of demand-side support models

- ✓ **DO** use the group model if you have expert and knowledgeable trainers who give credibility to the course and can attract participants. A completion certificate or some other form of acknowledgement may also be useful to motivate them.
- ✗ **DON'T** use the group approach if the enterprises need more tailored support or if your target group is too geographically disparate and it is not practical to bring the members together. It is worth noting that technology can help overcome this last challenge, as group support is increasingly offered online in the form of web platforms and webinars. These also serve the knowledge transfer purpose well; however, they can be very impersonal and theoretical.
- ✓ **DO** use competition schemes if you would like to canvas the visible and invisible demand side, as a wide variety of organisations and businesses might apply to an open call.
- ✗ **DON'T** use award schemes if you haven't got the time to promote your competition widely. If you can't promote it, you may only get a few applications, which could do you a disservice in the long run.
- ✓ **DO** use one-on-one support if you want to demonstrate a particular model or want specific social outcomes and impact. This is also the best form of support if you'd prefer to create your own investable social enterprise pipeline for other programmes.
- ✗ **DON'T** use a one-on-one approach if you haven't got the resources to invest for the long term. This type of support is time consuming and resource intensive and often does not result in immediate, spectacular outcomes. You can overcome this challenge partly by introducing interim milestones and awards, which can be promoted and information can be disseminated about.

93 UnLtd (n.d.).

94 UnLtd (n.d.).

95 Social Impact (2019).

Group and one-on-one support may also be successfully used in combination, for example, if the support programme requires basic information

4.5.1.2. Content offer

Capacity building and pipeline generation are crucial at all levels, not only in the early stages. That said, most support organisations do focus on the early stage and the typical menu of capacity-building support consists of 1) business strategy support, 2) access to networks and contacts, and 3) specific resources and service (96).

Almost all support organisations offer coaching and mentoring to social entrepreneurs and their teams, while many offer access to external pro bono experts. Access to networks includes connections to industry experts, potential customers and potential investors, as well as opportunities to meet peers. Finally, specific services may include media exposure, impact measurement or various learning resources and tools.

The topics covered in capacity building can be wide-ranging: some relate to enterprise development, while others are more about general organisational or strategy development. A few include business planning, market research, financial forecasting and modelling, business management, human resources, management information systems, sales and marketing, communications and PR, financial management and investments, governance and social impact management. While many of these business and financial concepts are still new for

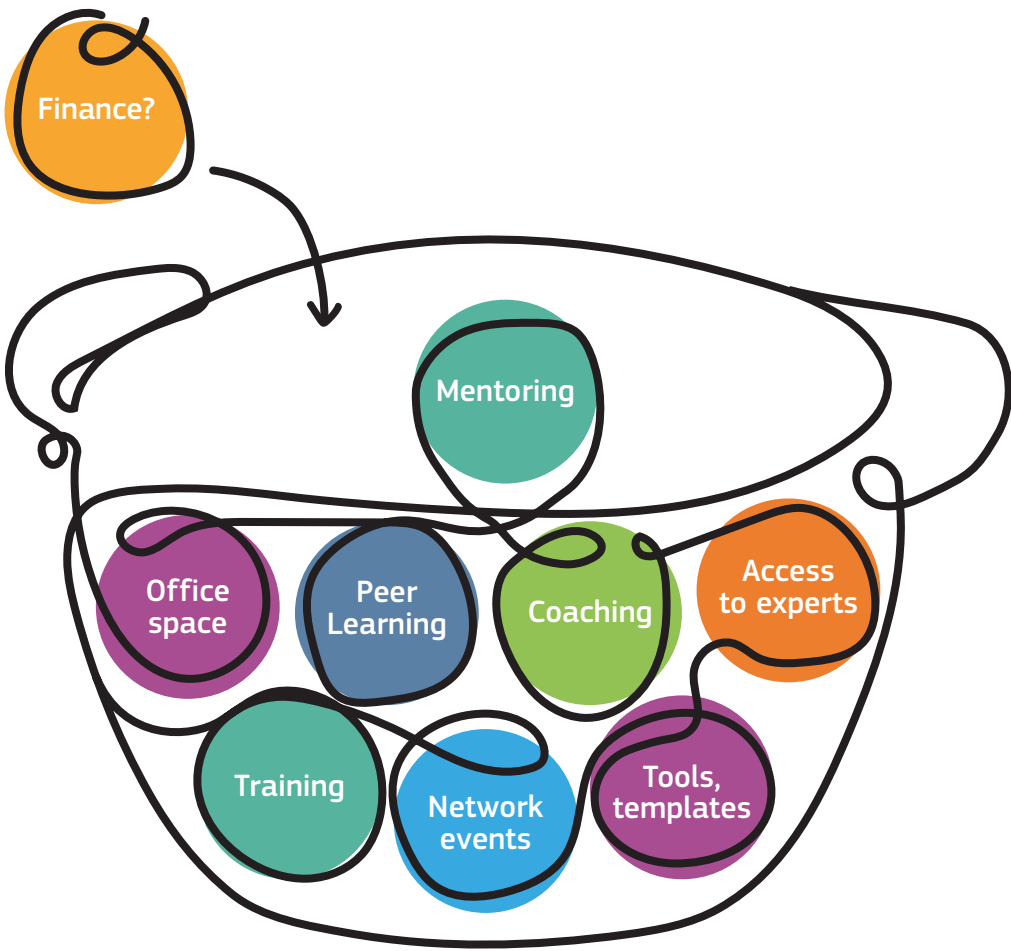
and knowledge transfer and/or if a group setting is needed to select participants for a further one-on-one programme component.

many organisations and start-up social enterprises, basic business planning and enterprise development support has become more mainstream in recent years.

As an increasing number of social enterprises are reaching the scaling stage and there is growing investment appetite, financing models and investment readiness have become important topics in capacity-building and support programmes. More and more social enterprises are looking to include social investment in their financing mix, so they are interested in learning about this from intermediaries and receiving support in brokering deals with investors. This presents a new challenge to support organisations, as they may not possess investment-related skills and experience themselves and therefore need to acquire this before launching an investment-readiness programme (see more on this in Section 4.5.1.4.).

Your assessment of the market (in particular, who provides what type of support), a closer assessment of your targeted social enterprises and an evaluation of the expertise at your disposal will determine what goes into your capacity-building support ‘mixing bowl’ (see Figure 15).

Figure 15. Capacity-building support mixing bowl



4.5.1.3. Financial support: Should you offer finance?

Any form of support costs money to provide; even pro bono support comes out of somebody’s budget. So, the simple answer would be ‘yes’. The offer of funding can also provide an extra incentive and makes social enterprises more responsive and accountable. But the answer is never simple. You should consider offering funding as a complementary element, if a) you have it or know you can get it when you need it, b) you feel it is necessary for your capacity building (or other non-financial support) to take full effect, c) nobody else is offering it for your target social enterprises or d) it is necessary for you and the supported organisation in order to demonstrate a social business model.

Financial support may be included because, even if you are a support organisation or intermediary, you may decide to provide small grants to your social enterprise clients/portfolio in order to incentivise them or help them through the most challenging parts of the bumpy road, namely, from early days to the growing phase. Indeed, there are many aspects of developing a new enterprise that require finance, be they market studies, legal fees for licences, incorporation, trademarks, accountancy and many more.

Support organisations, especially incubators and accelerators, usually include seed financing or small funds to cover the cost of capacity-building support in their package to enable the launch or growth of promising social enterprise ideas. If you have decided that funding should be an element of your support package, you will need to decide 1) what is the best way/financial instrument to provide it and 2) how you will select the recipients. For a discussion on financial instruments, please see Chapter 3. We would like to note here, however, that seed funding and capacity-building funds are almost always offered as grants as they tend to be small amounts, and the recipients – early-stage social enterprises – would not be in the position to repay them yet. According to GSEN's survey, some 77 % of their members offered grants in 2015, while only 20 % offered equity. In 2015, only 20 % did not offer any kind of financial support, but in 2017 this increased to 50 % of GSEN members, regardless of the type of finance considered ⁽⁹⁷⁾.

Selecting the recipients of financial support may be an automatic decision if your programme offers funding to everyone who is accepted, as is the case with capacity-building grants. However, if you are providing seed capital, it makes sense to offer it to those start-

up or idea-stage businesses that have drawn up a credible business plan and for whom funding will cover the costs of launch. Decision-making in such cases can rest on similar criteria to those you used for selecting programme participants (see Section 4.4.) or may take into account other criteria, such as repayment capacity if the funds are to be repaid.

If you set out to offer long-term capacity-building support, you will need to make clear if funding is for the long term or a one-off for the start-up phase. If funding is meant to accompany the capacity building and monitoring over a longer period of time, you will need to make sure that you can raise money to finance it and be clear about how many funding rounds you will support. Alternatively, the model may just be a one-off financial award with capacity building leading up to it, and with only capacity-building support for the rest of the time.

While funding is hardly ever turned down by investees, evaluations of support programmes show that social enterprises appreciate business strategy, advice and capacity building a lot more than money in the early stages.

4.5.1.4. What are investment-readiness programmes?

Investment-readiness programmes are one of many possible demand-side interventions. They target organisations and social enterprises that aim to take on social investment specifically. The goal is to put such organisations in a strong position to present their enterprise to different investors, to meet their requirements and thus help social enterprises tap into new sources of capital. Investment readiness focuses on an enterprises' business model: usually, growth and scaling, social impact potential and governance aspects in order to make it more attractive to investors. Investment-readiness support usually also builds the investee's finance skills and marketing and management experience, which makes the social enterprise a more competent and reliable partner for the investor.

Investment-readiness programmes try to address a number of gaps in the social investment market:

- the knowledge gap, as we referred to the lack of business and finance skills in Section 1.5.1.;
- the finance gap, namely the lack of access to capital for social enterprise development;
- the information gap, essentially the fact that investors and potential investees don't know enough about each other.

These programmes are thus meant to be a response to both a demand-side issue (the inability of social enterprises to access investment) and a supply-side issue (the lack of investable enterprises).

Investment-readiness programmes can be designed following the process we have described in this chapter

Social enterprise capacity-building programmes versus investment-readiness programmes

Classical investment readiness targets ready-to-scale enterprises that have a proven business model in their original markets and need capital to grow. In the SME sector, where the concept originated, investment readiness focuses on turning the company into an investable proposition and convincing the entrepreneur to use external capital. In the case of social enterprises, in addition to developing a viable scaling model, investment readiness has to include three additional aspects: 1) making sure that the business would be able and willing to take on **repayable** finance, 2) making sure that the enterprise would be able to **scale its social impact** while possibly (though not necessarily) scaling the business and 3) creating a **legal and governance structure** that would make investment possible. All three aspects are related to the very essence of social enterprises: the pursuit of social impact using an enterprise model. Traditionally, most projects and organisations targeting social impact take a non-profit form. They typically do not use repayable finance at all, because they do not need to, do not want to or because it is not available to them. As a result, considering social investment may require a cultural as well as mentality change from social organisations.

Following on from the original objectives, the key success measure for investment-readiness programmes should theoretically be the number and amount of (social) investment(s) raised as a result. However, investment-readiness programmes have

so far: deciding on your target, intervention focus, demand-side models and methodologies, funding and partners. Programmes may integrate all or many of the content elements of support discussed in Section 4.5.1.2., and may use a number of methodologies alone or in combination.

changed their focus and character, as it has become clear that the lack of investable enterprises is not only caused by the lack of proven and scalable business models, but also by inadequate governance structures or the lack of understanding of social investment among social enterprises. Many investment-readiness programmes, including the ICRF in the UK or the Stepping Stones Fund of the City Bridge Trust, concluded that some of the organisations they had supported were unable or unwilling to raise social investment at the end of the programme because it was either too early or inappropriate for them. This has also been the experience of some of the pilot projects, together with the discovery that, in a few cases, the best form of intervention was by way of grant. A few programme participants were not able to demonstrate a robust and investable business model, so can the programme still be considered a success? Has it achieved its goals? On one hand, yes: the success measures included increasing participants' skills and understanding of social finance options, so that they would be able to make an informed decision about using such finance. But on the other hand, another important goal of the programme – namely to help participating organisations and social enterprises raise social investment or to generate an investable pipeline for investors – was not met.

EXAMPLE: SOCIAL ENTERPRISE NL’S NEXT LEVEL PROGRAMME

Next Level, the investment-readiness programme of Social Enterprise NL, was designed with the aims of 1) preparing social entrepreneurs to successfully obtain social investment and 2) actively connecting entrepreneurs with impact investors. The programme ran for 3 months and offered five intensive full-day sessions to selected social entrepreneurs, who had the opportunity, both as a group and individually, to work with coaches to build their skills and meet with investors. During the programme, the entrepreneurs developed a clear strategy for scale, a commercial plan to deliver on the strategy, a financial plan and a strong investment case. The participants learned to ‘think like an investor’ during the programme and were challenged by their coach and several investors.

For Social Enterprise NL, an important outcome of the pilot project was learning about what social enterprises need in order for them to be better positioned to convince investors that they are investable. Social Enterprise NL will use this learning to improve the Next Level programme for future cohorts. In addition to skills, social enterprises need access to investor networks and to learn the language that they speak (see Section 3.1.). Social Enterprise NL also learned the importance of one-on-one support and the active engagement of coaches, who can also act as liaisons to the investor networks. As a concrete outcome of the programme, all entrepreneurs met with several investors. Some have learnt to grow without new equity, while other have found an investor or are still in discussion. Growth is not within reach for all entrepreneurs.

Two years on, the Next Level programme has run two more rounds with modified content. Based on learnings from the first round, Social Enterprise NL decided to make the programme more focused on obtaining investment and less on building skills; the final pitch event is therefore the highlight of the programme. During the last 2 years, the Dutch social investment market has evolved as well: there is now more access to finance programmes and more capital available for growth enterprises. The discussion has also opened about what type of capital is most appropriate and what is lacking. According to the Social Enterprise Monitor 2016, it has become easier to access finance and 83 % of social enterprises that were looking for capital (57 % of the total) succeeded in obtaining it ⁽⁹⁸⁾. Management consulting firm McKinsey reported in 2016 that the amount of capital available to social enterprises had tripled since 2010 ⁽⁹⁹⁾.

Social Enterprise NL decided not to scale Next Level as it feels it is already addressing the existing demand from its target group, which is the group of ‘interesting, growing and investable social enterprises’, rather than the start-ups or the fast-growing attractive social businesses that can find capital through their own networks. At the same time, Social Enterprise NL also learnt that keeping friendly investors close to the organisation is very important if it wants them to keep investing.

Investment-readiness programmes have also recently started to target a wider range of social enterprises, as more investors have appeared in the social impact investment arena and the demand for an investable pipeline has increased. As a consequence, more general business and organisational development components have been added to the capacity-building menu. As some investors tried to broaden their scope and move beyond the few successful and large social enterprises that everybody wanted to finance, investment-readiness programmes started to include early-stage or start-up social businesses as well. As a result, basic enterprise and business planning skills, as well as market building and strategy, have also been included in order to prepare programme participants for launching their business and, later on, for validating it in the market. Such investment-readiness programmes with a broader scope are very similar to social enterprise development and sustainability

programmes, which help create social enterprises and sustainable organisations. Those enterprises do not necessarily need social investment – in fact, it may not even be appropriate for their stage of development – however, sustainability and robust business models are also important for donors, who look for social enterprises that are capable of delivering impact. This raises the question of whether investment-readiness should include a broad range of support and start when social enterprises are launched, or whether it is misleading to label general capacity-building programmes ‘investment readiness’ in the hope of attracting highly desired new sources of funding. In fact, some of the pioneers of investment-readiness programmes now suggest that we stop talking about ‘investment readiness’ and focus on organisational resilience instead, as it better reflects the needs of social enterprises and non-profit organisations ⁽¹⁰⁰⁾.

Preparing for general investment readiness or individual investment

While focusing clearly on the social enterprises (investee side), intermediaries often engage with investors through investment-readiness programmes. There are three main reasons for this: 1) intermediaries are often the only ones that can connect investors to social enterprises (in nascent or young markets), 2) they wish to validate themselves by delivering successful investment deals at the end of the programme and 3) they hope to raise funding for themselves from investors who see their effectiveness.

Intermediaries therefore play a matchmaking role between investors and potential investees, and use investment-readiness programmes to secure the interest of investors. Some intermediaries may even offer an award or seed capital as a financial incentive to social enterprises that take part in a capacity-building programme. For example, IFUA Nonprofit Partner formed a consortium with Erste Group and ERSTE Foundation in Hungary to create and run an investment-readiness programme, which saw 12 successful business models awarded seed capital to aid the launch of their new businesses.

More advanced enterprises, on the other hand, have met investors and presented their models in search of investment of growth capital. In such cases, an investment-readiness programme may prepare the social enterprise for a specific investment product, for example a loan offered by a specific fund or bank, rather than generally to be able to meet investor expectations. This is also appropriate, provided there is no conflict of interest, because not only does the lender have targets to meet but, if the loan in question is the first social finance that the enterprise will take, it will help the enterprise build its credit history. Such an approach is particularly understandable in young social finance ecosystems where some of the deals resulting from investment-readiness programmes may be the very first ones in the market.

98 The largest survey of social enterprises in the Netherlands, carried out by Social Enterprise NL for the fourth time in 2016.
99 Keizer et al. (2016).

100 Tarokh (2018).

How effective are investment-readiness programmes?

Investment-readiness programmes have become very popular in recent years and have received a lot of funding and recognition. However, the jury is still out regarding their effectiveness. Investment-readiness programmes have contributed to the building and consolidation of many robust scaling business models so far, though not all of them have been investable. Reasons vary: limited return potential that does not meet investor expectations; mismatch of funding need and available finance; or inappropriate governance structure. After graduating from investment-readiness programmes, many social enterprises decide that social investment is not for them after all, or that they are not yet ready to embrace social investment.

If investment readiness focuses too much on investor tastes and needs, it runs the risk of bending the social enterprise business model too much and losing sight of the original social goals. Often there are inherent tensions between expectations and reality regarding the financial and social return potential of the social enterprise. Truly effective investment-readiness programmes should act as platforms for investees and investors to discuss these issues and find the best match for both parties.

Many investment-readiness programmes have not measured their impact or have not been able to show convincing data about how much investment social enterprises were able to raise as a result of their interventions. Some programmes and organisations, such as the ICRF or NESsT, have shared their learnings. See both examples in Chapter 6 with a more detailed discussion about impact management.

We believe that investment-readiness programmes can still be considered successful if they lead to investable social enterprises further down the line. Becoming ‘investment ready’ covers many aspects of a business and may take a long time, beyond the scope of a single programme. Skill development, capacity building and networking are usually also important objectives of investment-readiness programmes and most excel in these areas, adding a lot of value to both investees and investors.



EXAMPLE: RANGE OF DEMAND-SIDE SERVICES IN THE EU-FUNDED PROJECTS

Six of the pilot projects specifically addressed the demand side of their social investment markets in the first EU-funded round (2014-2016). They targeted a broad group of social enterprises and included a wide range of services. Some worked with very early-stage social enterprises (0-3 years old) with no fully developed business model and/or little experience with financing instruments other than grants. Others targeted growth-phase social enterprises that were looking for growth finance or working capital. Few of the projects had a sector focus. The services they provided included one-on-one coaching and mentoring as well as group training, networking events and shared facilities. Some providers focused on the management teams of social enterprises, while others included the board or specific staff members too. Topics ranged from financial planning and management, to business planning and marketing or PR. All pilot projects agreed on the need for social enterprises to receive support in impact measurement, including tools, implementation and tips.

An interesting question raised was the willingness and ability of social enterprises to pay for the capacity-building support. Most projects found that social enterprises were not able to pay, while some suggested exploring other (non-financial) ways that supported social enterprises could ‘pay’ for the services offered. It was also found that the success of non-financial support could depend a great deal on the absorption capacity of the recipient enterprise. One provider suggested that free-of-charge services are better received and incorporated, while one support organisation believes that clients

should be charged for up to 25 % of the cost of coaching and other services received.

Some providers subjected social enterprises to a due diligence process before they offered support services; this included a valid business plan and the existence of a full-time team and viable organisational financials. Other providers, one of which also provides loans to social enterprises, had a tailor-made approach to due diligence as well, saying that any support provided would depend on the amount borrowed and the risk this posed.

In the second EU funding round (2016-2018), investment-readiness programmes dominated the demand-side support. A number of capacity-building providers also included financial support at the end of the investment-readiness programmes; this was either in the form of seed grants, loans or matching them with social investors. According to recent experience, however, matchmaking is still a very time-consuming and resource-intensive process, regardless of how investment-ready the investee prospects seem to be.

A number of capacity-building providers included broader objectives in their projects, such as educating social enterprises about social investment or increasing funder and investor awareness of the impact potential and financing needs of social enterprises. Very few demand-side support projects focused exclusively on the demand side; they all concluded that work with social investors and other stakeholders was essential for success.

4.5.2. Supply-side support: Advisors and financial intermediaries

It would be misleading to judge investment-readiness programmes purely by the amount of investment raised by graduating social enterprises vis-à-vis the cost of providing the programmes. There are many other factors, besides the investable pipeline, that affect how much social investment can be raised. Work on the supply side is indispensable in order to educate investors and to connect them with intermediaries and social enterprises so that investable propositions are recognised.

Many players in the social finance field have identified bottlenecks and barriers on the supply side and have concluded that investors also need support services. Section 1.5.2. listed some of the most important barriers to investment, for example a perceived high risk of investment, high per-deal transaction costs, the difficulty of social impact measurement, a lack of understanding of social issues and small market and deal size. Some of these barriers may manifest themselves in unrealistic return expectations, a lack of relevant investment products or an inability to communicate with potential investees ⁽¹⁰¹⁾.

If the conclusions of your market assessment tell you that important barriers to growth are on the investor side in your market, you may wish to focus your support on the supply side. Even here, you may choose between different models, such as the following.

1. If the barrier is a lack of understanding of the social sector on the part of investors, leading to unrealistic expectations, you may choose to become an investor advisor or provide investor training and capacity building.
2. If the barrier is access to investments or a disconnect between what is on offer and what is needed by social enterprises, you may decide to play the role of facilitator or intermediary, delivering investable deals to investors.
3. You may want to address the above barriers by becoming a financial intermediary and offering investment management services to other investors. In such a case, you effectively become the investor for the social enterprises that you support.

EXAMPLE: CAPACITY-BUILDING SUPPORT FOR INVESTORS?

It must be recognised that very little support is given to existing and potential savers, or to investors interested in social investment but with little understanding of such investment or the markets it serves. Boards of foundations need particular support when it comes to making social investments. In 2018, the Association of Charitable Foundations in the UK appointed a dedicated member of staff to work closely with leading foundations with a view to develop a programme of support to new and developing social impact investors. It has also established the Social Impact Investors Group – a network of trusts and foundations interested in this area. On a retail level, the UK’s Charity Bank and other values-based banks offer their

investors, depositors and co-workers ‘days out’ to meet investee enterprises, but little (if any) time is allocated to how the assessment process works or to the assessment of risk. An exception to this is Banca Etica (Italy), which involves trained cooperative members in its credit assessment process.

The education of investors needs to address the risk in both a particular project and the wider enterprise, and whether those risks are adequately mitigated and priced. This gives rise to one issue in particular: what is a fair return for such investment and to what extent is it spread across financial and non-financial return?

In some markets, the intermediary and advisory sector is well developed, responding to investor demand and offering a wide range of services. Having such a variety of options may even lead to confusion about what investors need at various stages of their investment journey and how they can prepare for social impact investment. Figure 16 shows the possible range of education, research and strategy development that Tideline ⁽¹⁰²⁾, a consulting firm for impact investors, has drawn up to illustrate the US landscape: what is available and where the needs are. Having a wide range of intermediaries to support the supply side may be a symptom of a growing market in its formative stage. Yet it may also mean redundancy and inefficient support provision due to oversaturation, which points towards the need for coordination among supply-side advisors and intermediaries ⁽¹⁰³⁾.

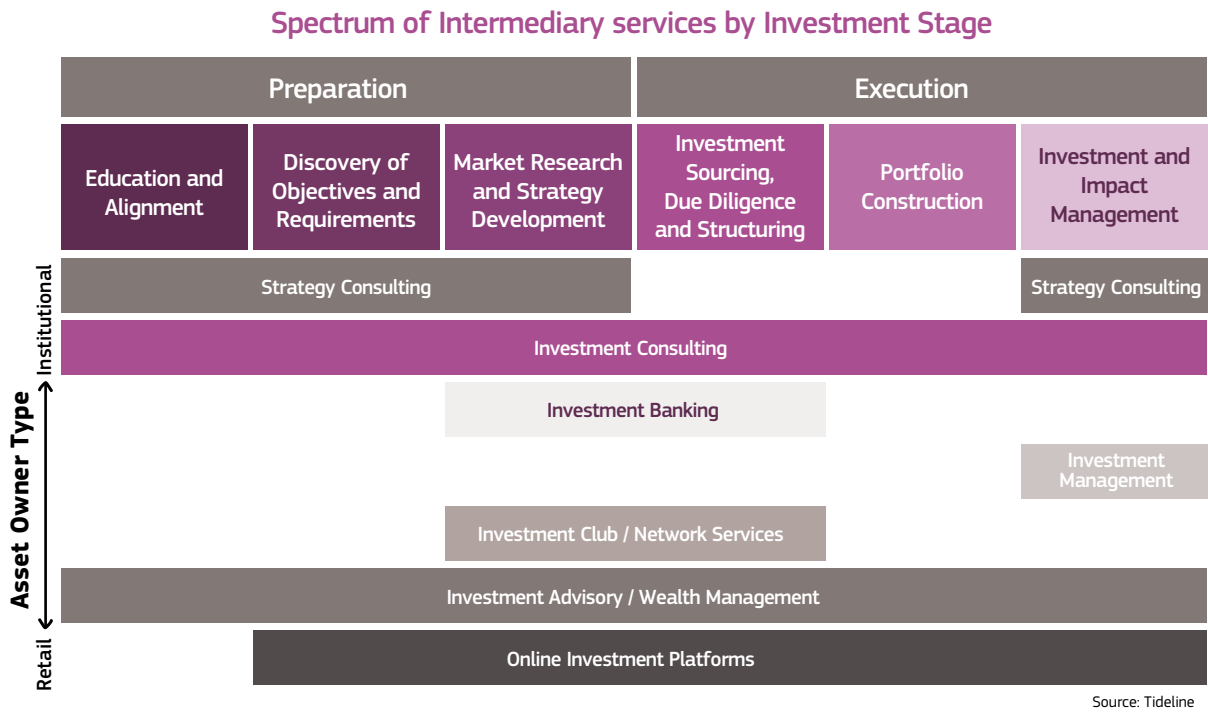
In less developed social finance ecosystems, few support organisations exist, and those that do may try to (or have to) fulfil the role of advisor at all stages of the investors’ development. If support organisations lack the experience and skills to meet these requirements, this can lead to suboptimal outcomes. If you find yourself in such a position, it is best to assess your skills and abilities honestly and share them with your investor clients and partners. Both parties may be interested in a pilot experience, in which case the learning – and not necessarily the perfect investment deal – is the desired outcome.

101 At the Good Deals + Beyond Good Business event in London in March 2018, investors mentioned the difficulty they faced when assessing the success of their investments in terms of social impact. Indeed, social enterprises questioned whether investors were themselves investment ready when expecting above-market-rate returns on their social investments. Source: Pioneers Post (2019).

102 Tideline (2019).

103 Seegull and Leijonhufvud (2017).

Figure 16. Intermediation services for impact investors
 Source: Leijonhufvud and Seegull (2018); Seegull and Leijonhufvud (2017)



In all cases, there is a diverse toolkit at your disposal, but investor support is usually delivered one-on-one rather than in a group setting, focusing on individual customers and deals. Exceptions may be lectures, conferences or matchmaking events, where several investors might be invited. The investor events organised by ClearlySo for their angel network ⁽¹⁰⁴⁾ (see also the example) or the Social Enterprise Day

hosted by NESsT ⁽¹⁰⁵⁾ are good practice examples of how to educate investors and create a concentrated meeting of supply and demand. Online tools that are available for social enterprises increasingly address social investors as well. One such example is the Social Finance Academy developed by Roots of Impact and referred to in Section 3.1.

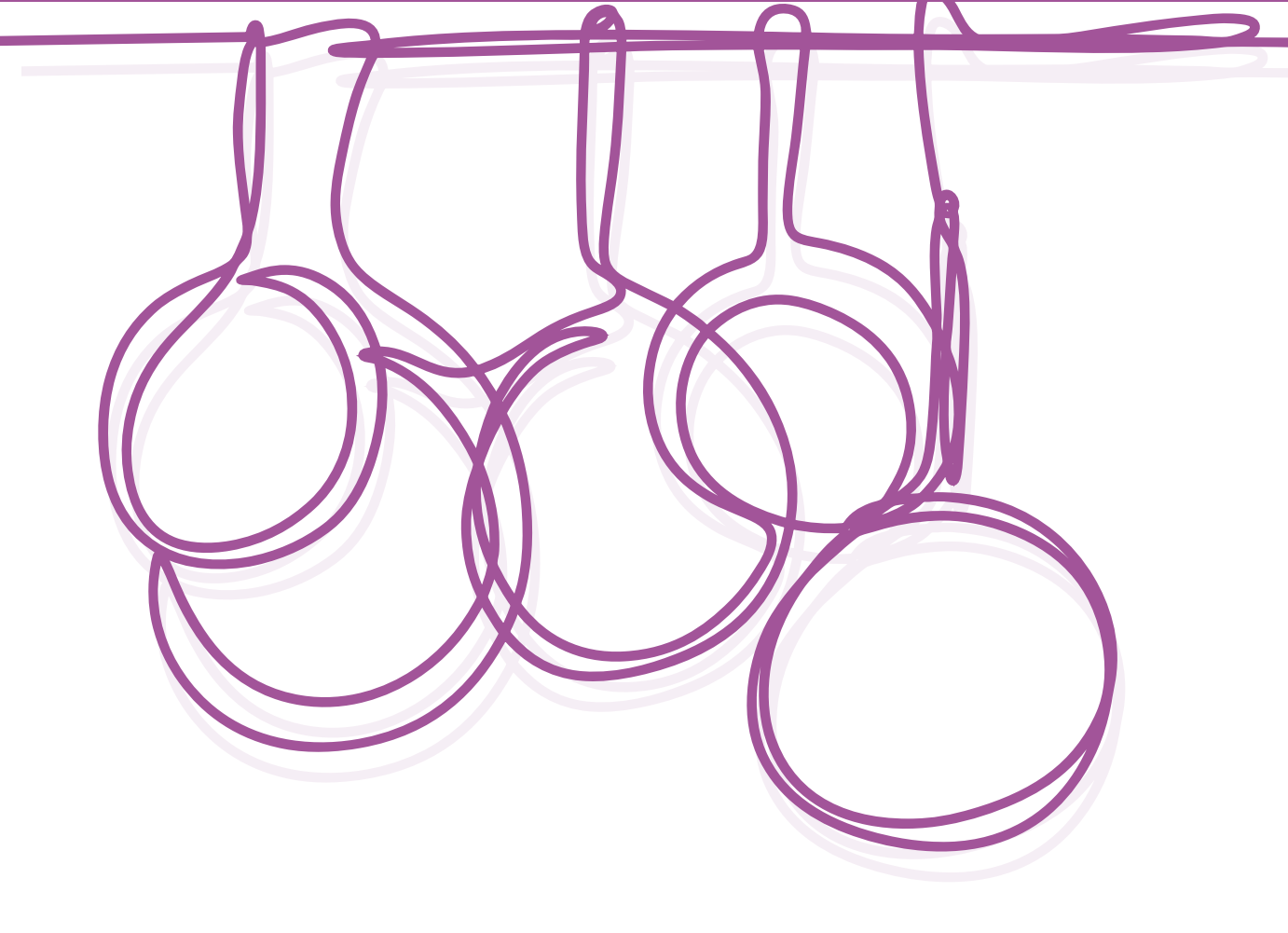
104 ClearlySo (n.d.b).
 105 NESsT (n.d.).

EXAMPLE: CLEARLY SOCIAL ANGELS

Clearly Social Angels (CSA), which was launched by ClearlySo, is the first impact angel network in the UK ⁽¹⁰⁶⁾. The organisation also plays an important market-building and investor-educator role. Angel investors that join the network are exposed to new ideas and new investment opportunities on a bi-monthly basis; ClearlySo introduces them to social entrepreneurs with compelling and innovative solutions to social and environmental problems who are looking for guidance and debt or equity in the GBP 200 000 to GBP 1.5 million range. Network members pay for the service. Using this network approach, ClearlySo can ensure that there are always enough interested investors

that entrepreneurs can pitch to and that the peer network attracts new investors all the time. ClearlySo also targets the institutional investor segment by offering structured impact investment opportunities (debt, equity and bonds) to banks, pension funds, foundations, housing associations and local authorities.

The company also runs an investment-readiness programme, working with social businesses to get them ready to take on debt, equity or other kinds of investment, and it offers charities the chance to prepare business and financial models for repayable finance ⁽¹⁰⁷⁾.



106 ClearlySo (n.d.b).
 107 ClearlySo (2019).

4.6. Collaboration: Partners and coalitions

You may find that there are many existing actors in your market, but they are small, not aware of each other or act in isolation. In this case, your most effective intervention would be as a market builder, focusing on various aspects and relationships. Such market builders are effectively intermediaries who have a wide range of expertise and networks. They often take an ecosystem perspective and work on legislation, policy, enterprise support, financing and awareness raising at the same time. Tackling many of these aspects simultaneously may be especially important if you are entering a nascent market where a lot of elements are still missing. Market builders may offer a range of support to social enterprises, but they may also want to influence other actors in the ecosystem to do their part and/or to act in cooperation. Such social enterprise coalitions or similar formations in a number of countries have grown into precisely that role and, once consolidated, they have become the advocacy organisation for social enterprises⁽¹⁰⁸⁾. As a result, national social enterprise strategies can be elaborated and they can guide government action and incentives to foster the development of the sector.

It can, however, be very challenging to fund market building, given that it does not benefit any particular actor exclusively. Experience shows that such activities are difficult to sustain unless they receive funding from independent sources (such as trusts and foundations) or the government. If market builders team up with membership organisations or become one themselves, membership fees may contribute to the resources available to them. Otherwise, they quite often provide specialised services, such as surveys and research, for others in exchange for a fee. National public bodies and the European Commission may also offer special lines of funding to support market building for social enterprise and

social investment. The Social Business Initiative and the EaSI (see Chapter 1) have allocated resources for precisely that purpose and for the exchange of good practices between countries.

Equally, market building can rarely be done by one single organisation, even if it starts out as a pioneer in the field. As soon as potential partners are identified (see Figure 6), partnership and coalition building is the best way to move forward. This is true for complex social investment market strategies as well as for the development of a specific instrument or support intervention. In Section 3.6., we considered the implications of collaboration and co-investment for financial investors. Collaboration and partnerships are also gaining popularity among support organisations, as they discover that partners may bring additional resources, networks and skills to the table and they are facing the challenge of sustainability. A number of support organisations and intermediaries consider partnerships and networks as their scaling or replication strategy, not having the resources to increase their reach and impact themselves. More discussion of scaling such initiatives follows in Chapter 7.

While generally considered beneficial, collaboration has both its advantages and disadvantages. Advantages of partnering with others include increased visibility and resources, increased speed and more strategic development of the ecosystem. At the same time, you should be aware that partnering may lead to too much compromise and to diverse interests slowing down the development process.

TIPS: HOW TO CONVENE AND MAINTAIN PARTNERSHIPS/COALITIONS

- No matter how you identify key players, research them thoroughly, focusing on their motivation and interests (both personal and organisational) in the social investment space and meet them as early on as you can. Ask yourself: *Do you share common values?*
- Find a committed champion in each partner organisation to be your internal ambassador. They don't necessarily need to be in senior positions, but they should be opinion leaders and/or close to the decision-making team. Ensure there is continuity if they leave or their role changes.
- Start with a smaller group of key partners; once the partnership is successful, others will want to join.
- Be strategic in selecting your partners: a well-resourced, high-profile organisation/individual can be crucial as long as they don't dominate.
- Constantly cultivate your partnerships. Inform them and involve them in meetings, decisions and public announcements. Find time to have fun together.
- Establish tasks and responsibilities at the start. This does not have to be a contract; a flexible MoU is often enough. There is a danger, however, that – as they are legally non-binding documents – MoUs will be ignored. Ideally, the MoU should be signed by the top decision makers (the board and CEO) in the partner organisation and progress reports should be sent to them as well. If issues arise, deal with them right away, before they grow out of hand. Your partnership may last for years, but one day your successors will wonder about the origins of the partnership. The MoU should inform that thinking.
- Define a specific, attainable goal for the partnership to work towards; this ensures that something is delivered and that momentum can be maintained (provided it is not another MoU).
- Select one partner to manage the partnership. Initially, this will most likely be you, so make sure you devote additional capacity and resources to this task. Partners' commitment could be increased if they are asked to contribute to the resource pool used to maintain the partnership.
- Communicate the outcomes to the external world, once you are ready; don't act in isolation and secrecy.
- Use one-on-one meetings as well as group discussions. Make sure that personal communication is part of the toolbox and that partners meet each other. They will see this as a networking benefit and will be more inclined to participate.

Partnering with other stakeholders may present a good opportunity for awareness raising and resource mobilisation. For example, numerous support organisations have partnered with companies and have successfully used corporate volunteers as advisors, trainers, mentors or business plan assessors in their support process. Key considerations when selecting a partner are:

- ***Do their goals and objectives align with yours?***
- ***Do their values align with yours? Do they bring any reputational risk?***
- ***What value added do they bring to the table in terms of expertise, funding and visibility?***
- ***What role will they play in the partnership?***
- ***How long will the partnership last?***

It is extremely important to agree on the roles and responsibilities of each partner in advance and to decide how the partnership will be evaluated, including both frequency and method. The lead partner (possibly you) has the additional responsibility of managing the partnership and motivating the parties. Before entering in a partnership, you need to make sure that the other partner has the capacity to undertake their partnership role and that other priorities will not override your project. This can typically be challenging in corporate partnerships, where business interests sometimes override those of the partnership, causing delays in implementation.

Convening key stakeholders and constantly motivating them could also be a significant challenge, especially for a small organisation. Experience shows that a lot of time and awareness raising is necessary for a multi-stakeholder meeting to take place and for participants to make commitments. This is especially true if large and/or government organisations are involved. Interest will always be the key driver, but quite often different parties have diverging short-term interests. While government agencies often want to see funds spent quickly and to bring visible results – for example, in the reduction of the unemployment of marginalised people – they may be slow to commit funds and agree to preparatory (investment-readiness) work. Quite often, partners do not pay enough attention to outcomes and follow-up, but want to focus on inputs and short-term outputs, often distorting the support programme.

Your summary questions for Chapter 4:

- Is there an existing support services market, or are you starting from scratch?
- Are you targeting the demand or supply side, or both?
- What is the value added of your capacity-building support?
- How will your value added complement existing financial and non-financial offers?
- What are the key elements of the support that you need to offer?
- What segments of social enterprise will you focus on? How will you select who to work with?
- How will you fund your services and your activities?
- What market building do you think you need to do, if any? What challenges do you anticipate?
- Do you have the resources to do this now, and can you attract more high quality resources as you grow?
- What are the pros and cons for you to start an investment-readiness programme?
- What kind of partners will be suitable for your vision? Are there partners you could work with?



Chapter 5

Pilot your initiative

Build your business model

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Learning objectives

On completion of this chapter, you should be able to:

- > understand the challenges facing new organisations;
- > decide whether you want to go it alone, partner with others or participate in an existing fund;
- > understand the key strategic issues you will have to address in building a fund;
- > understand the operational issues you will need to address and whether you may need to seek regulatory approval.

At this point, you should ideally have the following in place:

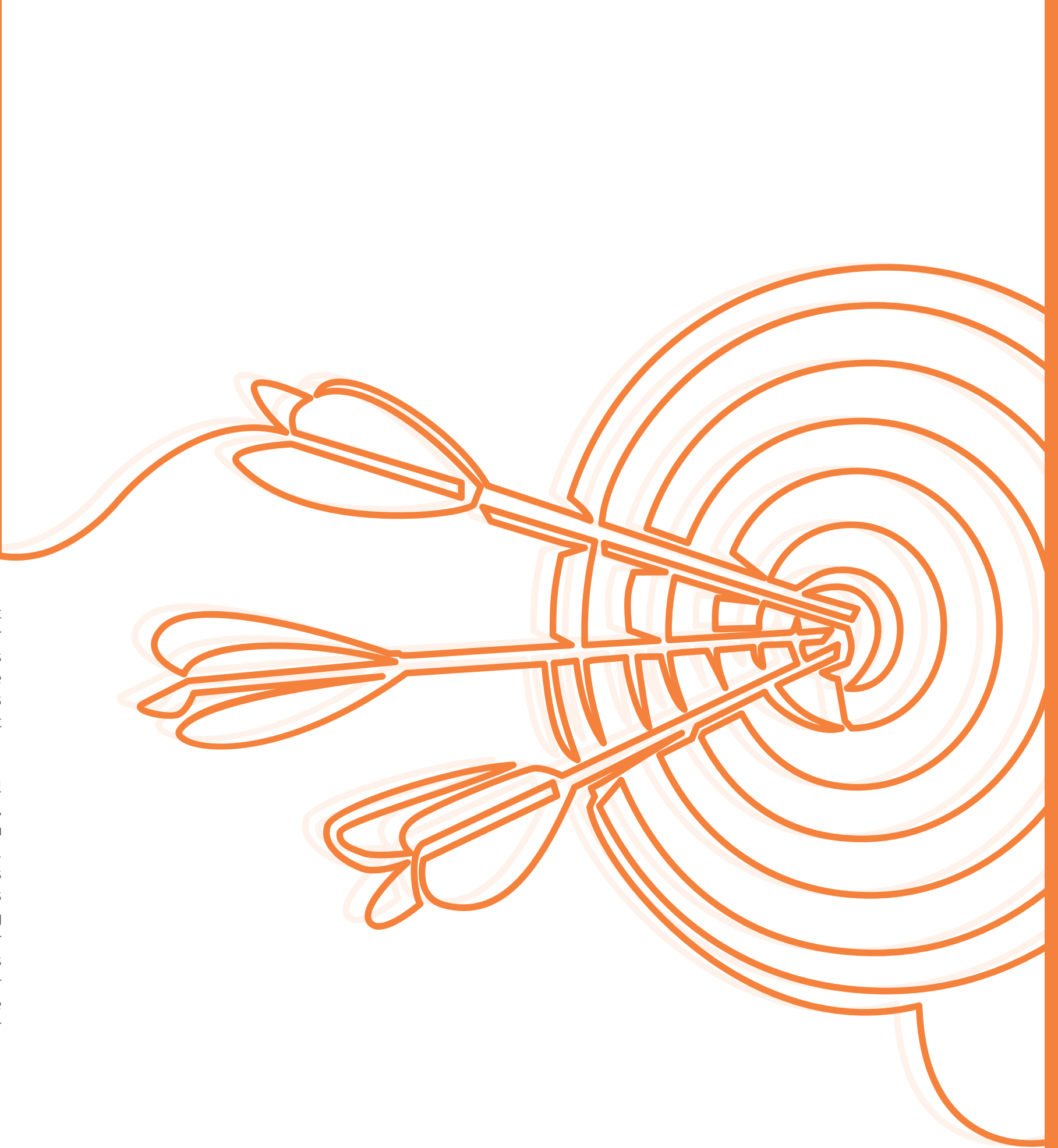
- > elements of a business model and business plan for your initiative;
- > an investment strategy (investors) or an intervention strategy (support organisations);
- > partners and/or co-investors;
- > a pipeline of investable social enterprises;
- > social impact objectives and a measurement system;
- > resources to launch a pilot.

At some point in the development of your business model, the question of money will come up. Whether you are an investor, an intermediary or a social enterprise, you are likely to have the feeling that more money than ever seems to be flowing into social impact investment. Many entrepreneurs, however, still find it difficult to raise capital, particularly during the early stages of growth. Investors can also find it hard to attract co-funders, especially in less developed markets, while intermediaries have to balance their independence and sustainability with their clients’ ability to pay for their services. Social enterprises are often told that their business is in an early stage and too risky for investment. Entrepreneurs may meet pioneer funders unconvinced by market demand or their ability to exit smoothly, while intermediaries are frequently challenged on the sustainability of their model.

There are a variety of business models that investors and support organisations can choose from. As with other businesses, these models include the general design for the successful operation of a business including identifying revenue sources, customer base, products and

details of financing. While traditional for-profit models have an ability to generate profit for their owners, traditional charities and NGOs (non-profits) seek to have the ability to generate positive change in the world. Social enterprises and social investors seek a balance between profit generation and positive change (social impact).

Whether you are trying to create and grow a social enterprise, an intermediary organisation or a fund, research has found that it is likely to be much more difficult than building a traditional business. You are not only aiming to provide new products or services to customers, often with low incomes and an aversion to changing long-standing practices, you are also likely to be faced with poor or non-existent infrastructure and supply chains and little space for reflection, mentoring or peer group support. All of these conditions will influence your business model and will be reflected in your roadmap, or in other words, your business plan.



5.1. Developing the business model for a financial investor

If you start out as an individual social investor or simply as one of the crowd, you may wish to develop your own fund or to co-invest alongside others. While many of the issues of development have already been addressed, there are some specific issues you will need to think about, for example, the sustainability of your funding initiative or investment vehicle if you are planning for long term.

There are a number of successful social loan funds whose business model rests on raising philanthropic capital and channelling it to social enterprises by offering simple repayable finance products to them. Yunus Social Business (YSB), for example, hopes that donor funding, capital repayment and interest payments from social enterprise clients, plus fee income from accelerators, will make their model self-sustaining over time ⁽¹⁰⁹⁾. Having been set up by Peace Nobel Laureate Muhammad Yunus alongside Saskia Bruysten, the Yunus brand clearly plays a significant role in attracting funding.

Instead of philanthropists or foundations, other funds raise capital from investors in the private and/or public sector and are generally expected to repay that capital from fund returns. Like YSB, Big Issue Invest ⁽¹¹⁰⁾ also considers itself a conduit of finance to social enterprises that want to deliver impact, though it relies solely on capital from investors (private, public, institutional, corporate and individual), which determines its business model. Again, like YSB, Big Issue Invest has the benefit of being part of a more established brand, in this case The Big Issue, which has a strong track record of raising money by selling its newspaper on the streets and as a foundation working with the homeless and marginalised. Mixing investment capital with donations or gift money in one fund

may seem like a good idea – especially, but not entirely, in young markets with limited amounts available for social investment – but, unless managed carefully, this can become difficult in terms of return expectations or the exit plans of the various investors and donors. Paradoxically, this is where different expectations of financial return can be helpful, as with hybrid financing.

Cooperative-type funds, on the other hand, offer shares to their members and require them to contribute to the capital of the fund. A key consideration for you will be *is the fund regulated?* If so, the regulator, as well as other stakeholders, may expect you to contribute more capital to restore ratios, whether caused by growth or losses. In addition to these examples, we recommend you also read Annex 2, which explains some of the possible business models for a local loan fund.

In developing and validating the blueprint of your investment model, you will need to take into account specific financial regulations and the extent to which these may shape your fund structure and your gathering of capital or other monies. For example, only regulated banks can accept interest-bearing savings deposits. You may intend to set up a crowdfunding platform in the knowledge that it is not regulated today, but be aware that draft regulation may be enacted that will limit your activities. How you raise your capital and the extent to which this will be invested or used to leverage other funds will shape your risk appetite. *Will all the work – particularly with customers, sifting enquiries, due diligence, credit review and application, documentation and repayment and recovery – be done by you or by someone else in house, or will it be contracted out?* Remember, reputation is everything.

In Chapter 3, we looked at investment strategies and the possible choices of financial instrument. You will similarly need to make key policy decisions in respect of:

- fund sustainability and scale
- interest rate policy
- fee charging
- extent, if any, to which security will be sought
- amount of due diligence you will do ⁽¹¹¹⁾
- portfolio risk tolerance, from zero upwards
- structure of the fund and whether there is a need for regulation
- sector(s) of operation.

These decisions, in turn, may affect your future investee base. If some social enterprises are unable to offer security, for example, or to accept interest rates that you wish to charge, they will be excluded from your portfolio reach.

109 Yunus Social Business (2019).
110 Big Issue Invest (n.d.).

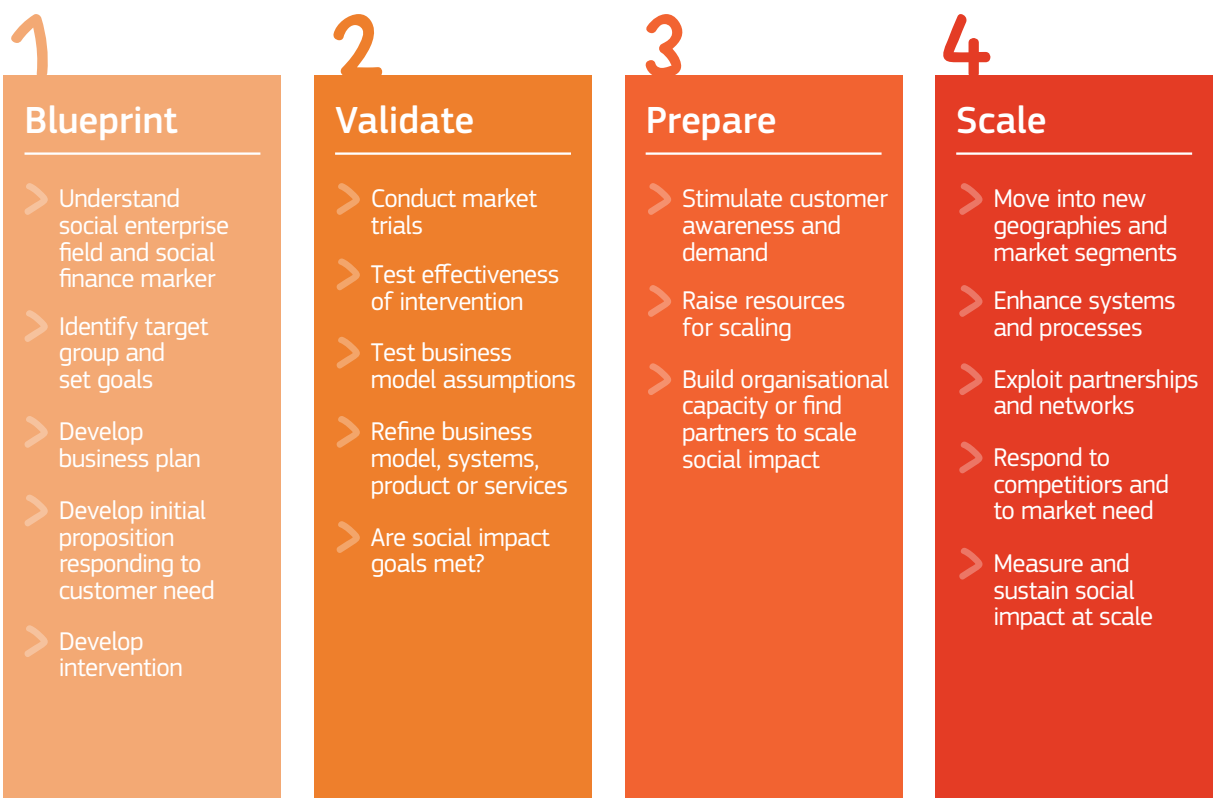
111 Some funds do little due diligence and absorb loan loss rates of upwards of 20 % a year (and sometimes go out of business), while others are truly diligent and have accumulated loan loss rates of less than 1 % in total (loss rates in excess of 10 % may do little to promote the idea that social investing is not a high-risk business whatever your approach to risk management).

5.2. Business models for support organisations

Chapter 1 looked at the life cycle of a social enterprise. Unless designed as one-off initiatives, support services and their providers go through similar stages of development, and they need to make decisions

about their own business models and sustainability at every stage. Figure 17 serves as a reminder of the development stages.

Figure 17. The life cycle of support organisations



The blueprint stage covers the research of the social enterprise field and social finance market that was described in Chapter 1, as well as the goalsetting and design of the intervention discussed in Chapter 4. The validation stage can be understood as a pilot and market-testing of the initiative or service, whereby the support organisation and/or intermediary validates its approach and methodology. **Does it generate the expected results and impact? Is there sufficient demand? Could it become financially viable?** If the validation is successful, outcomes or impact are achieved and more demand is identified, the support provider may consider scaling the impact, for example, by covering new geographies, targeting new types of social enterprises or simply increasing the number of enterprises supported. However, as the Dutch case study in Chapter 4 showed, not all support organisations will wish to scale their activities, for example if they feel that the demand has been satisfied. Preparation for scaling involves answering the following questions: **Could the service be rolled out if additional resources were made available? Or is there no further demand for the support offered? How do you go about identifying demand and potential partners, raising money and other resources and building organisational capacity to meet increasing demand?** These may sound familiar; in fact, these are the same questions that social enterprises would consider at a similar stage of development.

In your blueprint phase, you identified a gap in the provision of training or other services, such as legal and governance work or the provision of a platform. This has been borne out by research and engagement with the community: it is a real gap, not a perceived one. Your services could be generic, developing the capacity of a sector, through to intensive support to get an enterprise to a point where it becomes attractive to investors. As you move from blueprint to validation, you will need to finalise your own business model and test its viability by considering the following questions:

- **What is your service or product?**
- **Will your model be primarily donor-funded or based on revenue from the sale of services?**
- **Have you identified a paying customer base?**
- **Do you have a pricing strategy?**
- **Do you know your costs and the margin you need not only to cover costs, but also your need to reinvest in keeping your offer up to date?**
- **Do you know your market and competition?**
- **What are the operational considerations?**
- **What are the key risk considerations?**
- **How will all of the above influence your impact model?**

EXAMPLES OF INTERMEDIARY BUSINESS MODELS

The demand-side support projects funded by the second EaSI funding programme (2016-2018) summarised their experiences about the challenges of building sustainable business models. They have implemented, or wish to implement, several different models as outlined below.

➤ **Academic model:** Capacity-building programmes anchored at a university. This may strengthen the programme's sustainability, as it can use resources, teaching skills and rooms.

➤ **Impact hub model:** A relatively well-known model that provides operating infrastructure and adds the capacity-building programme on top, offered for a fee or funded by a funder. There is an existing management team. This appears to be a cost-effective model as the overall costs are shared between the physical space that a new enterprise needs and the capacity building programmes it needs. The intermediary is receiving some rental income while providing programmes.

➤ **Exclusive model:** In this case, the intermediary only offers an investment-readiness programme. This is probably the most challenging model to fund over the long term and can work best when the organisation enjoys long-term corporate support.

➤ **Fund model:** Some investment-readiness programmes decided to move in the direction of setting up a social investment fund. The main motivation was usually the lack of financing options for the social enterprises that had graduated from their programmes. At the same time, funds are possible revenue models, if the economics of the fund work out (itself a significant challenge) and if the intermediary organisation manages to raise enough money from investors who are also willing to pay for the investment-readiness piece.

There is no one dominant business model emerging and intermediaries will continue experimenting with a variety of income streams.

5.2.1. Sustainability of support organisations: Who pays for your services?

While the sustainability of an organisation is not only about money, funding is the single biggest challenge faced by social finance intermediaries and support organisations. It often determines what human resources and infrastructure you are able to obtain and how you can position yourself in the market. Your business model can also be very different depending on who your customers are and what delivery model you choose and can afford. Among others, your options include the following.

1. Deliver the support yourself, but only to the number of organisations that you can afford to support from the resources at your disposal. This may mean that you concentrate on one-to-many events or webinars rather than more intensive one-to-one support. One way to implement this could be to run an awards programme, as discussed in Section 4.5.1.1. The support organisation can deliver support during the programme and/or select organisations who will receive support as part of the award.
2. Contract out some of the programmes to third party suppliers who can provide these programme segments more cost effectively and within your overall budget. Quality control will be key to success.
3. Factor in (and gain) financial support from funders (e.g. foundations), ministries, companies and others who will pay you either directly or indirectly by funding the social enterprises (in some cases their 'portfolio') to attend the programme. This can be riskier for you, as you may have to share the money with other suppliers. You must know your delivery costs and how you will cover them. You may also find yourself encountering mission drift as your programmes develop to meet the needs of funders, not necessarily those identified by you.

4. Charge for your services. This may be obvious and acceptable in some markets but very challenging in others, where social enterprises are used to free-of-charge support. Charging at least a nominal fee can be very important though, not only for your financials, but also in order to make users value and appreciate your services. As noted earlier, social enterprises are usually thinly resourced; if a programme or a product is supplied free of charge, they may feel less concerned about not participating.

According to a GSEN report about scaling programmes for social ventures ⁽¹¹²⁾, accelerators largely rely on donor funding. Not only does it make them complacent and stop thinking about their revenue model, but it also brings programmatic restrictions, as donors usually dictate the terms. At the same time, GSEN suggests that non-repayable finance is very useful, especially for programmes targeting early-stage ventures, and that support organisations can use those funds strategically to build their own sustainability. Most support organisations have some revenue from clients, be it social enterprises or investors, although they rarely rely on them completely. Most often, their funding is a mixture of sales revenue (fees and contracts), grants and subsidies.

Public sector grants and subsidies are also used by many support organisations but, in the face of budget cuts, new resources need to be found. The GSEN report suggests that corporations could become viable partners and are in a good place to provide not only financing, but expertise and other types of pro bono support, which could positively influence an intermediary's bottom line. When the Bright Red Dot Foundation, trading as CAN (formerly Community Action Network) ⁽¹¹³⁾, was set up in the UK, their first 'partners' were large corporate companies including Coca Cola. Similarly, Social Business Trust was started together with the founding partner of global

112 Goni and Bingham (2018).

113 CAN (2019).

investment fund, Permira, whose partners also include large companies such as British Gas, IBM, Thomson Reuters, Bain & Company, Credit Suisse and EY ⁽¹¹⁴⁾. Both organisations share a belief in the benefits that working in partnership with business can deliver in helping social enterprise address society's problems. Both CAN and Social Business Trust provide interesting examples of progression from classical support organisations to embracing finance and property amongst their resources.

While support organisations would like non-refundable capital, traditionally very few grantmakers have been interested in funding intangible things, such as strengthening enterprise or investment readiness. However, this is changing, and today there are a growing number of private grantmakers and public authorities that recognise the value of better skilled, more robust social enterprises. Such non-refundable capital may be part of a legacy strategy to leave a sector or a community better equipped after state withdrawal or a decision by a foundation to spend down its endowment. It might also align with the wider objects of a charitable foundation. That said, a significant hurdle remains in that, in many countries, foundations are restricted in what they can fund and, while social enterprise is for societal good, it is not always considered charitable.

Either way, you will need to demonstrate the impact you expect your work to achieve and how you will continue to operate once the funding ceases. In some cases, you may be able to secure multi-year funding, which will allow you to reach out to a wider number of enterprises and initiatives, delivering, say, one-to-many support and/or training trainers who can then reach out to progressively wider numbers. Sooner or later though, the issue of your own sustainability will arise and that means you may need to charge for your services. There is a delicate balance to strike, as you cannot risk running out of funding mid-programme, leaving your portfolio without support.

When trying to charge for your services, you are likely to discover that the enterprise(s) you want to work with is not used to paying for advice or support and may not be able to afford it. If you are offering help on a pro bono basis, you are absorbing the costs yourself. If, however, you are helping an enterprise with its plan and developing each piece of a value chain, then you are likely involving expert advice, which has to be paid for. You also have insurable risks in the duty of care you owe to your client(s), as well as professional indemnity. This may be compounded if you are helping more than one enterprise. While intermediaries recognise the value to an enterprise of pro bono work, in the longer term it raises issues for the sustainability of the intermediary and, as a consequence, for the viability of the market.

You can use a sliding scale pricing strategy with your customers, whereby those with a stronger payment capacity pay more and thus 'subsidise' the lower price you offer to social enterprises with more limited resources. If this is done transparently, the 'wealthier' clients are likely to accept it without question. However, you have to be wary of watering down your risk appetite by shifting your emphasis towards those that can afford to pay.

An example of sliding scale pricing is demonstrated by some law firms who work closely with social enterprises and investors; they do not offer pro bono support after an initial, free-of-charge meeting. Instead, they offer a 'Robin Hood service' where 'wealthier' clients subsidise the cost of services to those who cannot afford their normal fee rates.

A FEW THOUGHTS FOR FOUNDATIONS ABOUT SUPPORTING INTERMEDIARIES

If not enough of the right type of finance is finding its way to front-line organisations, it is just as true for intermediaries or non-financial support organisations and the development of the market infrastructure. Working with an intermediary can also extend a foundation's reach and complement its knowledge and skills. Here are some ways that a foundation could support the development of the social enterprise market infrastructure by working with intermediaries:

- > pilot new funding ideas, initially with grants, possibly convertible into other instruments (including repayable ones) as the initiative develops;
- > underwrite new approaches to finance;
- > provide the grant (equity) tier in a layered transaction;
- > partner with agencies, such as the EIF, in providing shared guarantees;
- > commission with specific outcomes in mind, i.e. create the demand for certain types of intermediary interventions;

- > be a 'devil's advocate': provide funding for reviews and learning, and publish evidence of what does not work;
- > exchange ideas and knowledge;
- > introduce your grantees to the intermediary and provide long-term support for them in the relationship;
- > fund support services provided by intermediaries;
- > provide a long-term funding stream to strengthen the intermediary's work, so that you can support them through the essential change management that will result from growth;
- > provide long-term funding for longitudinal impact studies.

In many of these cases, the foundation and the enterprise can structure the support with way markers that can allow the funding, or other resources, to be increased or cut off. It is clear, however, that this is just as much a journey of discovery for foundations, many of whom will need time to come to terms with social investment.

A NOTE ON USING PUBLIC SECTOR OR EU FUNDING IN YOUR BUSINESS MODEL

While this guide is intended for private and institutional actors, public funds and EU sources merit mention because of their importance in many countries either as catalysts, or because they might be the only source available for measures fostering the development of the social enterprise and social investment markets.

Support organisations and non-financial intermediaries have typically been able to benefit from two of the European Commission's structural and investment funds (ESIF) in the past: the **European Social Fund (ESF)** and the **European Regional Development Fund (ERDF)**. The ESF covers social innovation, social enterprise development and social investment-related programmes. The European Commission's 2014-2020 programming period includes an investment priority specifically designed for social enterprises promoting social entrepreneurship and vocational integration in social enterprises and the social and solidarity economy in order to facilitate access to employment'. Annex 5 offers more detail about the possible ways ESF funding can support social enterprise development and finance by investors as well as intermediaries.

The development of social investment markets is also covered by the ERDF, which has more experience and flexibility when it comes to handling financial instruments. Not all countries, however, have used these funding facilities explicitly to support social enterprise and social investment. In those countries, social enterprises and support organisations have had to create programme proposals that not only met their original objectives, but also those of the employment or social care policy goals of their governments.

A number of additional facilities and instruments have been introduced by the European Commission since 2014 to stimulate the development of social finance markets (Annex 5 also provides a detailed description of the main instruments supporting both the supply and demand side). **EaSI**, for example, provides support to financial intermediaries that offer microloans to entrepreneurs or finance to social enterprises. The aim is to address existing market failures and foster the development of the emerging social investment ecosystem through a comprehensive package of financial instruments and grants. The projects listed in Annex 1 and referred to as illustrative examples throughout the guide have all been able to take advantage of funding from the EaSI programme in their endeavours to strengthen the supply or demand side of their social finance ecosystems. In addition, the **European Fund for Strategic Investments (EFSI)** includes social impact investment instruments, which enable the piloting of a number of innovative instruments in support of social enterprises and social innovation.

In the 2014-2020 programming period, lessons learnt from the 2013-2017 period have been incorporated in the regulations governing the use of the ESIF. For example, the use of financial instruments within the national and regional operational programmes has been encouraged, and more detailed guidance and technical assistance has been offered to public authorities who had previously been used to dealing with grants ⁽¹¹⁵⁾. The reader should refer to Annex 5 for information on the programming period 2021-2027.

The offer of national public funds varies a great deal, being practically non-existent in some countries while abundant in others. Without describing the specific financial instruments or schemes that governments have used (for example, Big Society Capital in the UK), it is worth considering these key questions before you decide to apply for such funding:

- *How does the use of public funding affect your independence (politically and in terms of financing mix)?*
- *Are you able to meet the administrative and reporting burdens that public money requires?*
- *Are you financially strong enough to weather cash flow fluctuations caused by possible late disbursements?*

- *Is public funding crowding out private investment you could have considered?*
- *Is the finance repayable? If so, do you have the source of repayment?*
- *Are there implications for your mission if you accept the funding?*

Managing authorities of structural fund programmes are required to conduct an ex ante assessment before setting up a financial instrument using EU funding. They will follow a similar assessment to the one recommended in this guide: assessing the social investment market (its failures and gaps), the value added and the possible impact of the financial instrument, plus the potential risks. You may want to be aware of their process, their findings and the resulting programme/instrument, as they may affect your niche in the market and your ability to use EU funding for your social investment or support programme.

115 The fi-compass library contains a wide range of learning resources covering a variety of topics related to financial instruments under the European Structural and Investment Funds; see FI Compass (2019).

5.3. Operational considerations of development

Some operational considerations are common to financial investors and support organisations. These can be both internal and/or external. If you are moving from blueprint to pilot stage, you will need to keep in mind that the pilot may or may not validate your assumptions. You will therefore have to have contingency plans in place in the event that you are more successful than you expected, or piloting does not support your assumptions sufficiently to sustain a viable business going forward.

5.3.1. Internal considerations

- Talk to your team and keep them informed about what is happening and how things are going. Share challenges as well as successes: they may have a solution you hadn't thought of. **What are your own plans, and how do these affect succession planning?**
- Ask yourself whether you need to formalise your management structure or even strengthen the team. **Are you over-reliant on one or two key people?**
- If you did not start out with a board, **is now the time to select one and put in place a governance structure that will continue to be appropriate as you grow?**
- If you are developing as a financial investor, you may require regulatory approval or acceptance of your key staff, board and advisors.
- When you started, you may have run your financial projections, accounts and systems on your own personal laptop or used someone else's. Now is the time to consider your operating and financial systems' needs.
- If you are developing an investment or loan fund or a mutual you may be about to fall under national and, possibly, European regulation. It is important that you establish what reporting requirements they have, who produces software acceptable to the regulators and how adept those firms are at anticipating future regulatory changes. Talk to other investors about the systems they use and meet other users of your favoured software. They will give you far more useful information than the manufacturer.
- If you are providing support services or just investment, **can you get project management software to help you track and report on your portfolio?**
- **Is the software compatible with your accounting system, or will you be faced with a challenging workaround? Does it work in your currency and language?**
- **Are your premises and location right for you?** Being located outside a capital or large city may bring you cost savings in rent.

If the pilot is successful and you feel your model has been validated, you will need to consider a number of factors, both internal and external, as outlined in the following sections.

5.3.2. External considerations

- Share your plans with your existing investors. Let them know what this will mean financially and structurally. If you bring in new investors, **will your existing backers be diluted? Will they buy in to further funding rounds?** Be clear about their intentions and minute these in meeting notes.
- Your piloting will begin to reveal to you the extent to which the market (i.e. your clients) will need to be educated. In your target geography, for example, lots of people may borrow money for personal reasons, but the same people may never have borrowed in their social enterprise capacity.
- **Have you got the resources or the skills to provide this capacity building? Or would you rather contract it out – or at least partner with others so that you can influence the content of the services offered?**
- Partnering with networks, other financial investors and support providers can help you establish effective distribution channels, which in turn stimulate customer demand or investee pipeline.
- If you pursue one of the EU or national funding schemes, be aware that there are caps on the amount of government-subsidised investment an enterprise can receive over a 3-year period under EU rules. Similarly, there is a cap on the total amount of investment an investor can make. This is described in detail in the EU State Aid rules ⁽¹¹⁶⁾ and is often referred to directly in structural funds' calls for proposals.
- Remember that, as the number of intermediaries and support organisations grows, you may be in competition for enterprises to join your cohort or portfolio. Competition need not be purely within your own country either; an applicant to join one of the pilot projects' programmes withdrew because it had an offer of a place on a programme in Silicon Valley, for example.
- Mohammad Yunus observes that we have to prove ourselves worthy of our financial services provider when it should be the other way around. Take time to ask yourself: **Am I worthy of my enterprises?**

5.4. Communicating your service with transparency

Unless you are very lucky, customers will generally not find you. Not only do you need to communicate your service or product, but also your mission and your values: a growing number of social enterprises want to buy from or work with other social entrepreneurs, or at least people with similar values. You will need to communicate the empathy and value added you bring to an initiative. CAN, for example, proudly publicises that it is itself a social enterprise, as does Charity Bank. (If you're questioning how you will know whether

you are providing something that is needed and that enterprises are willing to pay for, see Chapter 6.)

A key part of communication is transparency. You must be transparent in everything you say and do: what you are doing, why you are doing it, the values that guide you as an investor or as an intermediary, and who it is for. Equally, you should be clear who you do not work with. So, if you are not prepared to work with enterprises without an asset lock, for example, say so clearly and

mean it. If you only work in healthcare, make that clear. If you do not offer enterprises a right of appeal, make sure this is known. This will save you time and heartache later. You will also need to communicate who your team is so that your customers, your regulator (if any), your funders and other stakeholders can draw comfort from and have confidence in the capabilities of your

team. As noted in Section 5.3., communicating with your team and with all your stakeholders is essential. In fact, you have a responsibility to share your results and your learnings. Hopefully this will not only build confidence in you, your team and your work among key influencers, such as funders, but this will also help those that follow in your wake.

DEVELOPING YOUR OWN FUND

If you want to develop your own fund, remember that without financial sustainability, there can be no mission. But you must remain true to your vision throughout.

- > Bring together a multidisciplinary team. In the case of a fund, mix seasoned lending and credit bankers with community development workers, micro-financiers, researchers and activists who all share the vision.
- > Everything takes longer than you expect, especially making your first loan or investment. Manage expectations on all sides.
- > Test all your systems before the regulator does.
- > Be transparent with everyone, but especially with your team, board, investors and regulator. None of them like sudden surprises, and few know your business as well as you and your team (should) do.
- > Find space for reflection and team thinking, but also find time for everyone to have fun together outside work.
- > Communicate success and learn from everything.
- > Delegate within and outside to partners. You cannot be good at everything.
- > Be on top of the finances and the key ratios.
- > Listen to your customers, encourage feedback and be willing to change products or services that aren't working. Be open about what isn't working and why.
- > Showcase case studies. They are powerful communication tools. Back them up by arranging days when your stakeholders and staff can meet borrowers and learn more about how you work. Encourage each investor to bring a friend.
- > Don't overcommit. Do outperform.

Your summary questions for Chapter 5:

- > Are the most important elements for implementation in place?
- > Have you ensured the financial basis of the pilot, and do you have a plan for how you will achieve sustainability in the long run?
- > What are the key risks that affect your pilot?
- > Do you want to scale your model? If so, what are your top three considerations when deciding how to go about it?



Chapter 6

Assess impact and evaluate

How do you know if your pilot project is successful?

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Learning objectives

On completion of this chapter, you should be able to:

- > understand the impact management process and your impact at investee level;
- > think about key considerations for your impact at portfolio level;
- > consider the impact of your initiative on the social investment market;
- > design an impact management system taking into account the biggest challenges.

At this point, you should ideally have the following in place:

- > a validated and refined business model for your initiative;
- > resources needed to develop the next stage;
- > social impact lessons learnt from the pilot.

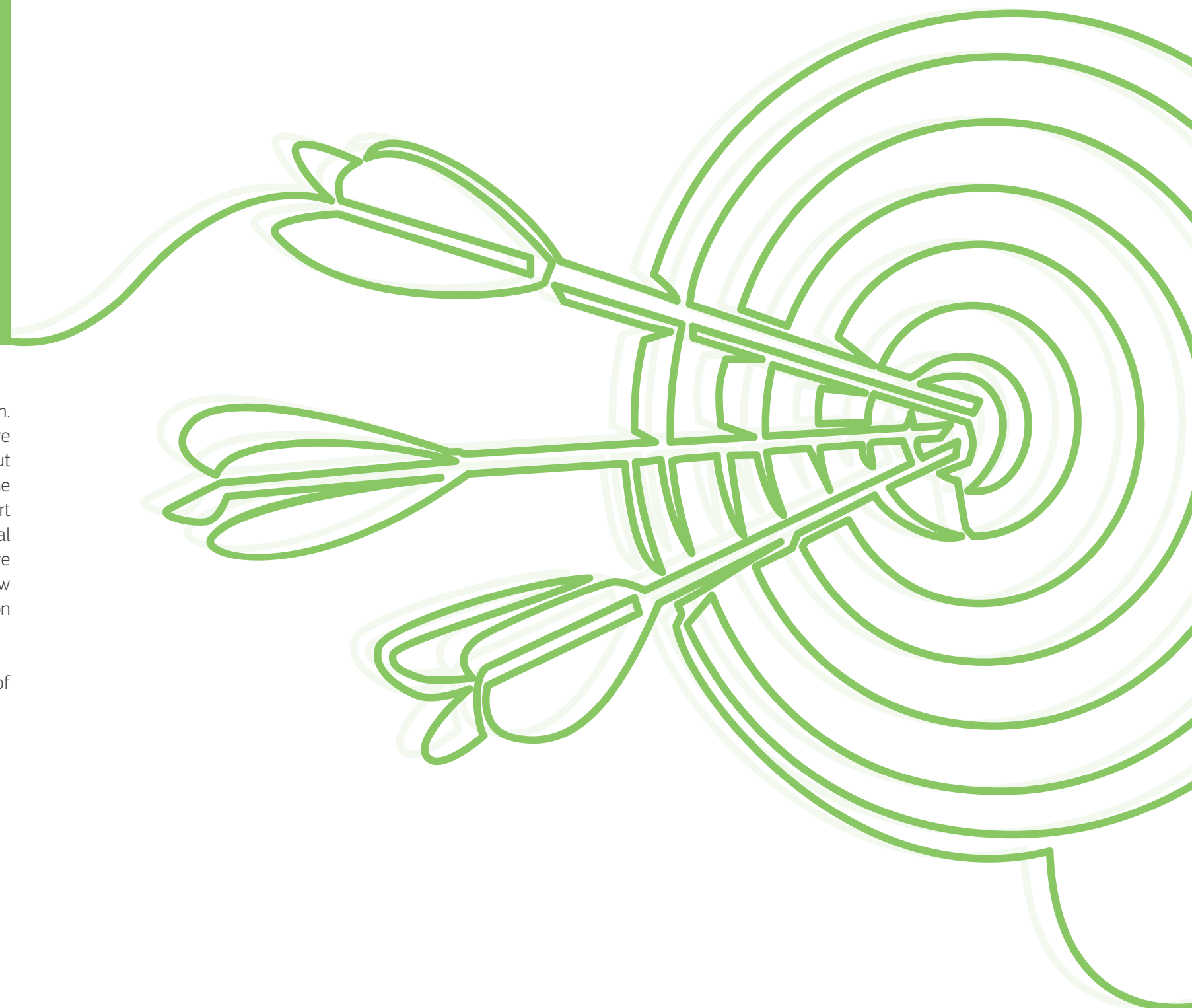
This chapter is about ‘eating the cake you have baked and having it judged by a panel’, in other words, how to evaluate the performance of your pilot initiative from financial and social perspectives. The critical and delicate balance between financial return and social impact is especially key for social investors, who must see their investees succeed financially if they want to be repaid their money or earn a financial return.

At this point, you will need to return to your vision and goals, as these are what you will want to compare your performance against. Your goals and return expectations will also reflect your risk appetite, which in turn determines what sort of trade-off, if any, you are prepared to accept when it comes to financial and social returns. *Did you achieve the social impact you set out to achieve? Did you manage to stay at your chosen spot on the investment spectrum (see Chapter 1)? Or did you end up moving towards one end rather than the other?*

You have established your baseline for comparison. Your market assessment should also have provided you with the baseline information about the existence and/or effectiveness to-date of the financial instrument or capacity-building support you have utilised. Your due diligence of the social enterprise(s) – your potential investees – will have given you their individual baseline. You now know what you are assessing against, but the question remains how to do it.

We will examine the performance and impact of the investment at the following three levels:

1. investee
2. investor/intermediary
3. social investment market.



6.1. Impact of the investment at the investee level

Your investment or capacity-building intervention will have had an impact on your investee in two ways. Firstly, it will hopefully have increased or improved the social impact on their beneficiaries. Secondly, the investment is likely to have affected your investee as an organisation or company. They may have built a stronger business model, more efficient systems and better monitoring, and they may have improved their knowledge and skills as a result. These are areas that most support organisations target with their interventions. Investors may not specifically state improved knowledge and skills as their goal, but may realise in the end that this is an additional outcome.

Measuring enterprise performance and financial results is everyday practice in the commercial world and can be done using standard sales and profitability indicators. While you can use these measures when

looking at the financial position of a social enterprise, they will only tell you part of the story. The quantity and increase in sales, revenue, profit and cash flows can indicate the health of the enterprise, and you should be able to track these indicators easily if the investee has the basic systems from which to extract the data. However, though this may be enough for a regular investor, a social investor will also want to consider the quality of the income and whether this is reinforcing the enterprise's mission. If the enterprise is part of a payment-by-results scheme, such as a social impact bond, then an unsatisfactory social impact could lead to financial issues, as the investor will not get paid by the commissioner unless agreed outcome indicators are met. It is the 'social value' of its work that makes a social enterprise social, and it is this aspect that we now turn to.

6.1.1. The social impact management cycle

We now focus on social impact management ⁽¹¹⁷⁾, which most investees and investors find more challenging than tracking financial performance. Social impact management is not only about measurement. You need to know why, as well as what, you are measuring – and what you will do with the data/information you obtain. There are a great number of publications and methodologies available. If you want to dig deeper into social impact measurement, refer to the sources and websites included at the end of this guide. Here, we will not attempt to describe all the existing methodologies; rather, we will offer a social impact management logic – the social impact management cycle – that we believe to be relevant for most social investors and that we find to be a very useful starting point. It was developed by EVPA, based on its experience of venture philanthropy investors. This logic was then largely adopted in 2014 by the Sub-group on Impact Measurement of the European

Commission's Expert Group on Social Entrepreneurship ⁽¹¹⁸⁾, and recommended for the EaSI programme and the EuSEF regulation. It can thus be considered the basic logic to approaching social impact. Once you start working through it, you can add variations on the measurement methodologies, indicators and impact analysis as you see fit.

This process shows the five key steps in a sequential order (Figure 18), but it is in fact a continuous cycle, in which learnings and reports feed into the objectives of the future. At the heart of the process lies the social impact, which you should always consider when taking management decisions in the management of a particular social investment.

Figure 18. The five steps of social impact measurement

Source: © European Venture Philanthropy Association (2013)



- **Setting objectives:** This should happen at both investee and investor level. The latter should have already happened when you, the investor, decided what you wanted to achieve with the investment. The investee, on the other hand, should know what impact they want to achieve in their social sector for their beneficiaries.
- **Analysing stakeholders:** You will need to identify who will be impacted by the social enterprise and the nature of that impact.
- **Measuring results:** In this step, you translate the objectives into expected outputs, outcomes and impact, and select the most suitable indicators and methods of measurement. An assessment of needs and resources should follow to decide where on the impact value chain

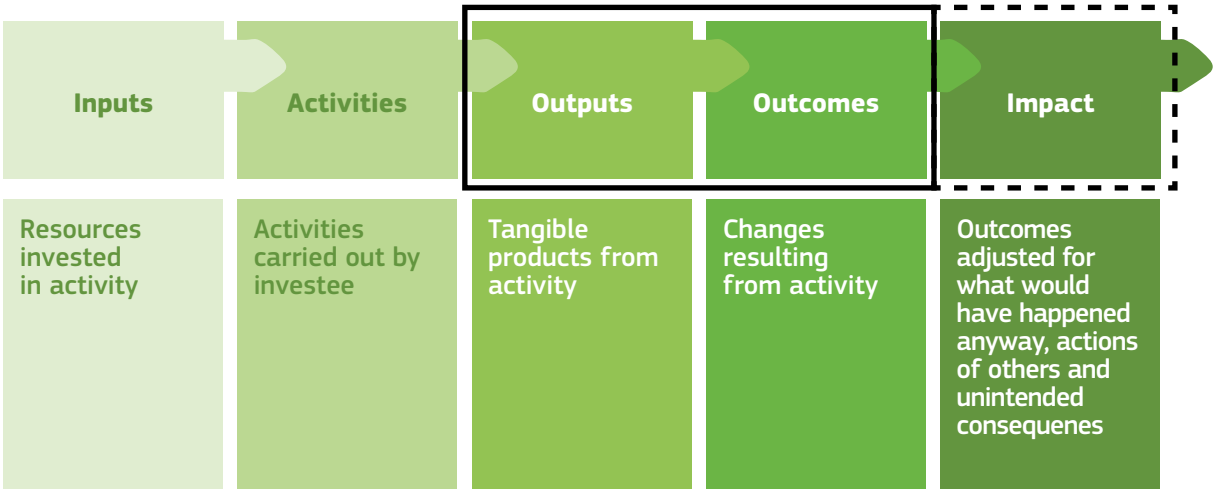
the social enterprise should focus (Figure 19), what indicators are most relevant and what measurement methodology is feasible. The key consideration should always be what is in your investee's best interests; agree to select indicators that will help the social enterprise manage and understand their business and social impact. Generally, it is most feasible to focus on output and outcome measurement in the short and medium term, while impact measurement may be a follow-up, longer-term exercise that possibly involves research and surveying by third party experts. In Exercise 4 at the end of this chapter, you can find some guiding questions to help you select the most suitable measurement method and indicators.

117 Throughout this guide, 'social impact' is used as shorthand for social, as well as environmental, impact.

118 European Commission (2014a).

- **Verifying and valuing impact:** This step includes verifying whether the impact happened as it was supposed to and whether it was valuable for the stakeholders. This step could require desk research, interviews and benchmarking against other investments or funds (if such benchmarks exist).
- **Monitoring and reporting:** In this last step, you need to make sure that data is captured and recorded in a systemised way, that it is available for interpretation and analysis and that it will be possible to aggregate it. While data matters, qualitative information is equally valuable, and you need to find a way to present both the quantitative and qualitative information in the most suitable form.

Figure 19. The impact value chain
Source: Adapted from European Venture Philanthropy Association (2013)



Social impact management for the investees should ideally start with their enterprise plan, which should describe the social issue, the target beneficiary group, the proposed solution (including activities and outputs), the expected outcomes/impact and how to measure the outcomes. If your investees do not have such a business plan, you may start by helping them create one.

Another approach is to write an impact and evaluation plan, as suggested by Nesta in its guide *Investing in Innovative Social Ventures* ⁽¹¹⁹⁾. Such a plan would cover six areas: 1) a description of the product/service that is supposed to have an impact; 2) a tight definition of the target population; 3) an evaluation plan specifying outcomes, indicator measurement,

data capture and people responsible; 4) an outcome statement describing the effect the product is going to have on someone in the beneficiary group; 5) a definition of measurement units and targets for growth and 6) a public benefit statement.

The management of your investment/intervention's impact should ideally have been included in your vision and investment strategy document and your work plan with the investee. Your due diligence and market research will have also identified areas for improvement, be they in the business management, financial modelling or communication areas. Measuring progress in these areas is key for capacity-building and investment-readiness programmes, as their direct impact on the social enterprise is

assessed in those terms. The impact management cycle can be a logical and consistent way to measure and manage this direct impact too.

A classical pitfall of impact measurement is 'overclaiming'. Investors and support organisations are at least one level removed from the direct beneficiaries, so it is difficult for them to decide what

happened as a result of their intervention and what should be attributed to policy change, for example. Investors also often invest in social enterprises that receive funding from other funders too. So the challenge is how to identify and measure the specific impact that your investment made, capturing contribution rather than attribution.

EXAMPLE: THE NESST PERFORMANCE MANAGEMENT TOOL

During 15 years of portfolio management, NESsT developed and piloted a performance and social impact management tool for its social enterprise investees that builds on the 'balanced scorecard' metric ⁽¹²⁰⁾ and provides the basic data for aggregation at the portfolio level. (The balanced scorecard includes goals, targets, baseline and indicators, and measures performance of each at regular intervals.) Therefore, NESsT aimed to design a tool that could be expanded by its users.

The tool is a simple-to-use spreadsheet containing individualised indicators for each social enterprise that can be used to set goals and measure progress in four key areas: 1) enterprise performance, 2) social impact, 3) organisational development and 4) financial sustainability. Goal setting takes place jointly, and social enterprises are responsible for regular measurement and reporting to NESsT.

While indicators are tailor-made and set by each investee, there are some so-called 'flagship indicators' that everyone has to measure and report on. NESsT uses the flagship indicators for the aggregation of its diverse portfolio of social enterprises. As a result, it is able to interpret and communicate outcome data, such as an increase in employment opportunities or the improvement of livelihoods, across the portfolio. NESsT also initiated integration with the IRIS database and reports on four to five standard indicators that are harmonised with IRIS definitions. The system is always a work in progress, but the NESsT social enterprises are now all able to build their impact measurement capacity, better communicate their own outcomes and can thus present more attractive propositions to other funders and investors.

119 Nesta (2015).

120 European Venture Philanthropy Association (n.d.a); the 'balanced scorecard' metric was developed by Professor Robert Kaplan (Harvard Business School) and Dr David Norton in 1992 as a 'performance management framework that added strategic non-financial performance measures to traditional financial metrics to give managers and executives a more "balanced" view of organisational performance... [it] transforms an organisation's strategic plan from an attractive but passive document into the "marching orders" for the organisation on a daily basis', helping people to identify what should be done and measured. Source: Balanced Scorecard Institute (2019). In partnership with Professor Kaplan, the Boston-based New Profit has adapted the scorecard for the non-profit sector by adding the 'social impact' perspective.

6.2. Impact at the investor/intermediary level

Investors can also use the impact management cycle to build their own impact management system and measure the social impact of their portfolio by taking your market assessment conclusions (Chapter 1), strategy decisions (Chapter 2) and investment strategy (Chapters 3 and 4) as inputs. You can follow the same steps at portfolio level as was suggested above for managing the impact of an individual investee.

- 1. Setting objectives:** The objectives of the investor and investee should be in sync. This might sound like an obvious requirement, but quite often harmonising social impact objectives and expectations is difficult. Investors need to be realistic about the capacity of their investees and the impact potential of their social enterprise model, while also being able to challenge the investees to aim high. A wide range of tools, such as the theory of change or logic models, are available to think about the objectives.
- 2. Analysing stakeholders:** Stakeholder assessment and analysis was part of your market assessment, so the information you collected then could now be used and supplemented with information directly obtained from re-engaging with them.
- 3. Measuring results:** When selecting your methodology and indicators, you should consider first and foremost the interests of your investee social enterprise, specifically, how impact measurement will help them manage the business and what you can reasonably expect them to deliver. In the case of a diverse portfolio, aggregating outcome/impact data will be an important objective, but a formidable challenge for the investor. The use of quantitative change indicators (e.g. percentage change in people obtaining employment) or monetary proxy indicators (e.g. savings by household thanks to

a new product) may be the answer, as those could be applicable across a diverse portfolio as well. You may choose to take care of impact measurement yourself and to commission social impact studies, instead of requesting data from your investees, which has its advantages as well as its costs.

It is most likely, however, that data collected by/ from your investees will feed into the impact measurement system at the portfolio level (this is how information is fed into NESsT's performance management tool). That may or may not be enough, depending on the measurement capacity of your investees and the complexity of the social issue area. You may also, for example, have to do some desk research and data collection yourself to assess the possible negative effects of your investees on their own or on other target groups or to calculate the effect that other people's actions had on the target beneficiaries.

- 4. Verifying and valuing impact:** The use of standard indicator sets such as IRIS (see Chapter 1) could be useful in this step, because it makes your output and outcomes data directly comparable with that of other investors who use IRIS.
- 5. Monitoring and reporting:** Your social impact report will contain conclusions about the performance of your investee and will reflect on the effectiveness of your investment and non-financial support. How will you incorporate the learnings into your investment process? Will the conclusions change your intervention model? Will you start to invest different amounts or in different sectors? Will you need to improve your tools to help investees measure their outcomes/impact?

EXAMPLE: INCO’S SOCIAL IMPACT METHODOLOGY

INCO is a catalyst that supports and invests in green and social start-ups in 28 countries. Founded in 2010, INCO has a unique model: it supports a wide range of entrepreneurs at every stage of their development, helping them to refine their ideas and grow their enterprises, while ensuring they develop economically viable models that have social impact at their core ⁽¹²¹⁾.

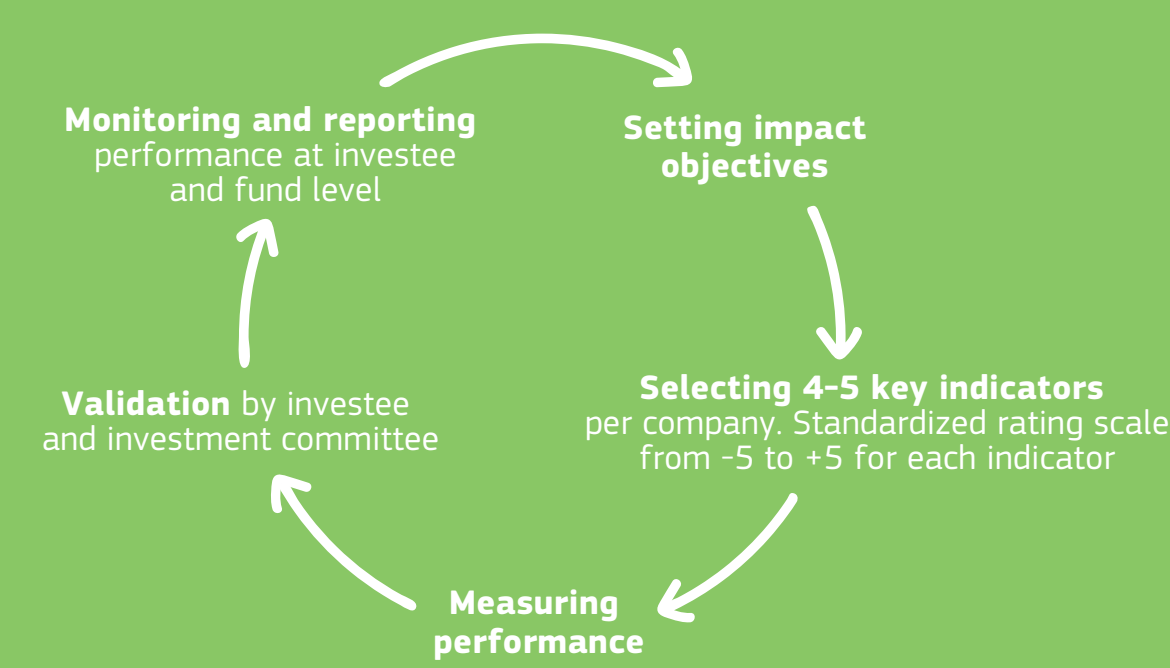
INCO’s support includes training, acceleration support and investment, which is delivered through two entities: INCO, a venture capital firm managing four impact investment funds and INCO.org, a non-profit organisation that provides training and acceleration programmes to entrepreneurs. INCO is a patient investor, supporting entrepreneurs for an average of 9 months before investing. Investments range between USD 100 000 and USD 5 million (approximately EUR 88 000 and EUR 4.4 million).

INCO has also developed INCO Ratings, a methodology tailored for green and social businesses through a set of 600 financial and non-financial indicators. It allows for the complete financial analysis of the portfolio companies, the assessment of their business model, market opportunity, value added and growth potential.

INCO’s social impact methodology reflects the logic of the social impact management cycle. It follows the same approach as INCO Ratings and was developed jointly with the Caisse des Dépôts et Consignations and BNP Paribas when the NovESS Fund ⁽¹²²⁾ was launched in 2016. The resulting framework is the French impact measurement and monitoring standard, MESIS ⁽¹²³⁾. The methodology enables a complete impact assessment that can be applied in seven social sector fields: employment, housing, health, education, poverty, microfinance and the environment. The system contains 12 ‘extra-financial (non-financial)’ fields. It can be used both for the impact assessment in the pre-investment phase (i.e. due diligence) and for impact monitoring during the life of the investment and again upon exit, when the final impact evaluation takes place.

The system also includes transversal social impact indicators, which allow for portfolio-level aggregation. These are: the number and quality of jobs created, the number and profile of beneficiaries, the volume of services/products/ actions proposed and the positive externalities affecting the beneficiaries as a result (for example health benefits).

Figure 20. The impact management system of INCO
Source: Inco (n.d.b).



Using the above methodology, INCO has reported its overall cross-sector impact as follows:

- invested assets of USD 150 million;
- created over 100 000 jobs through its portfolio;
- supported 1.5 million children and 2.3 million low-income individuals;
- trained 300 000 people;
- avoided 4.5 million tons of waste;
- saved over 500 000 trees ⁽¹²⁴⁾.

121 Inco (n.d.a).

122 NovESS is the leading impact investing fund in France, initiated by the Caisse des Dépôts. NovESS was launched to finance social organisations falling under the French law of 31 July 2014, operating in the sanitary, social and medical, energy transition and circular economy sectors. Source: Caisse des Dépôts (n.d.a).

123 Caisse des Dépôts (n.d.b).

124 Inco (n.d.b).

Using the impact data for future investments

Once you have collected and analysed the social impact information, the question is: *What's next?* Now you need to ask yourself: ***What will you use the data for? Are you planning to validate a social enterprise or new outcome model? Are you going to share your findings with the rest of the field? Are you going to try to raise more funds for further investments and support using the evidence? Are you going to revisit your assumptions and basic goals? Are you going to modify your investment strategy? Has your risk appetite changed?***

Some think that social impact data needs to be used in order to make effective investment decisions in the social sector; in other words, to compare the performance of investees within a portfolio and to be able to report on impact at portfolio level. While many argue that this can be achieved by the standardisation of impact measurement indicators, others believe that comparison should only be made at the analysis stage of impact data, when skilled analysts interpret and compare the information received from individual investees ⁽¹²⁵⁾.

6.3. Measuring the impact of your investment on the social investment market

The assessment of impact on the social investment market requires a different approach. You need to go back to your market assessment and examine what role your investment/intervention actually plays in the market now and what other changes have taken place in the meantime. You might find that today's market and environment are significantly different from those that existed at the beginning. The evaluation of the impact of your investment can be especially interesting if it is an instrument that was introduced for the first time.

Has it added to the market? Has it met the expectations of expanding the range of financing available to social enterprises? If you intended to be a catalyst, did you manage to encourage other investors to add liquidity to the market? If you are an intermediary, have you brokered more interesting deals in greater numbers? Was your targeting right, and did you serve the greatest need? Have you perhaps squeezed out other actors or instruments?

The timeframe for such an evaluation is a very important factor, as some of the changes (positive and negative) can only be captured over the long run. This is especially true for investment-readiness programmes, where cultural and mentality shifts are required in addition to skill building and matchmaking.

There is now also an increasing desire and effort to share both good practices in non-financial support and social investment market data across Europe as well as globally. Impact on the entire social enterprise and social investment market is not captured, except when a new instrument or scheme is introduced. However, even in such cases, it is hard to assess additionality and the possible crowding-out effect.

125 Ruff and Olsen (2016).

6.4. Challenges in social impact management

Investors and investees face numerous challenges in the impact management process. Some of these mostly concern the investee, while others show up more on the investor/intermediary side. However, it is safe to say that because all investee challenges in impact measurement and management will affect the investor as well, all parties need to be ready to deal with them. Indeed, as Table 10 shows, some of the challenges affect both sides.

You can overcome a number of these challenges by providing support, both financial and technical, to the investee to build their capacity to measure and manage impact. In the UK, for example, this realisation led to the establishment of the Impact Readiness Fund ⁽¹²⁶⁾, whose main objective was to provide funding to organisations to build their impact management capacity. Experience shows that it will take one or two rounds of investment for investees to get used to the impact measurement tools and to understand the value added, in addition to seeing it as a reporting tool to you.

Dealing with common challenges involves a lot of conversation between the investor and the investee and will usually require dedicated resources, especially on the investor's side. If impact is difficult or impossible for the investee to measure, you will need to decide whether you can invest in building their systems so that they can capture data or whether you will fund external evaluation of some sort. Some challenges can be overcome with 'practise', while others are more far reaching and can probably only be overcome with time, as more experience and data are accumulated. This means that it's difficult to know whether a model and its results are replicable in the short run. But don't be discouraged if your impact management system is not perfect from the start; the important thing is to start somewhere, implant the impact-focused approach and work together with your investees/ portfolio to collect the information.

126 UK Government (n.d.).

EXAMPLE: THE IMPACT OF THE ICRF (UK)

A special example of investment-readiness programmes is the ICRF, which was funded by the UK government and run by Social Investment Business. The ICRF spent GBP 13.2 million to support 155 social ventures, not just social enterprises, to prepare them to more successfully bid for public sector contracts and to take on external investment.

The UK social investment market can count on a variety of support organisations and social investors, and the public sector is a potential market for social service provider enterprises. Hence, investment and contract readiness addressed two important gaps: funding and market access. The programme ran for nearly 3 years (2012–2015), and an evaluation study was published in October 2015 ⁽¹²⁷⁾. It reported that the GBP 13.2 million spent unlocked GBP 233 million in additional resources: GBP 154 million in contracts and GBP 79 million in investment. That is GBP 18 per every GBP 1 spent by the Fund on support. Analysis shows that the beneficiary organisations were more successful in bidding for contracts than in trying to secure investment for several reasons, which are related to skills as well as the availability of contract opportunities compared with the availability of social investors. According to the interviews with beneficiary organisations, a large number felt that they would not have obtained the deals without the ICRF support. The majority also said that the support led to sustained changes in their organisations, which will enable them to continue to be contract and investment ready. According to the evaluation, some of the main lessons learnt include that:

- support needs to be flexible and tailor-made;
- investment readiness can be viewed as a journey, and future funds need to be aware of which part of that journey they want to support;

- funds need to consider the sustained, long-term impact of the support on social enterprises, especially since the ICRF funded project-based, targeted support provision;
- investment and contract readiness need to be separated, as they have distinct objectives.

Many social investors have found that the leverage impact of their direct investment in a project existed in unlocking other resources, whether as the cornerstone investor or as the ‘missing piece of the jigsaw’; that is, they encouraged others to become social investors. The ICRF also had an impact on the support services market by 1) making some of the providers sustainable, as those were paid for with ICRF money and 2) attracting ‘mainstream’ consultants and thus broadening the choice of providers, but also creating competition. Indeed, the ICRF has now also been reconstructed and passed on to Big Lottery to fund, which may result in a widening of its scope.

The question of whether this is a good use of government or philanthropic funds, or whether such funds should be allocated to other uses, is still discussed. If we consider these sources as first-risk or enabling funds, which can help strengthen beneficiaries and which in turn attract more private sector funding, the money is well worth spending on investment readiness. At the same time, if it crowds out other funding sources or mostly ends up paying for the intermediaries (and perhaps making them complacent), publicly funded investment-readiness programmes may be looked upon more critically. The recommendations of the 2015 evaluation study – some of which are critical – would be useful inputs into the design of any future contract and/or investment -readiness fund ⁽¹²⁸⁾.

Table 10. Challenges in the impact management process

Challenges on investee side	Common challenges	Challenges on investor side
Tendency to focus on needs assessment rather than impact	Understanding what is meant by social impact	Aggregating impact data at portfolio level; comparing investments within the portfolio
Lack of measurement culture	Agreeing on impact goals/expectations	Short-termism preventing focus on long-term impact
Availability of project-based or anecdotal evidence only	Lack of outcome/impact mentality	No long-term follow-up after investment
Lack of resources for impact measurement	Communicating the impact	Assessment of potential impact of the investment/instrument on the market
	Lack of systemic approach/ methodology	Interpreting impact data received from the investee; avoiding the tendency to over-claim
	Lack of skills, know-how or simply resources	
	Impact is difficult or impossible to measure	
	Impact can be measured only in the very long term, exceeding portfolio/investment lifetime	

127 Ronicle and Fox (2015).

128 Ronicle and Fox (2015).

TIPS: HOW TO OVERCOME SOCIAL IMPACT MANAGEMENT CHALLENGES

- > Offer carrots (funding or other valued opportunities) to the investee and make them conditional upon the delivery of outcome/impact indicators and reports.
- > Provide examples of other organisations' impact indicators or reports.
- > Ask investees how they already measure and report impact and consider adopting their methodology.
- > Allow time and offer individual attention; it may take one or two rounds for investees to understand the impact measurement tool and integrate it into their own practices.
- > Explain to investees how you will use the impact information and share the reports/ external communication with them.
- > Dedicate resources for impact management both to the investee and yourself.
- > Set aside resources for long-term impact measurement.
- > Talk to other investors about their practices and offer comparisons or use them as benchmarks.
- > Start with a few fundamental indicators to make aggregation easier.
- > Avoid over-claiming by building a robust impact model that takes into account your theory of change at every step of the impact management cycle. Use collective impact models ⁽¹²⁹⁾ when co-investing with others.
- > Make sure the cycle is complete: there should be a feedback loop and impact data should influence activities and decisions going forward.

Developing new business models in any market can be hard work. The challenge of building a new business serving customers (who may not even see themselves as customers) who have never had a functioning market in these services before means that time horizons are long. If you want your funders to support you through this period, you must be able

to persevere and demonstrate enough progress to know that your solution has the potential to become a sustainable business. You may find the road a lonely one: peers may come from outside your sector, and there may be just one or two. You will have to find the time to step back and think strategically.

Your summary questions for Chapter 6:

- > What are your impact objectives?
- > How will outcome/impact data serve your investee?
- > What is the capacity of your investee to implement the social impact management cycle? If capacity is insufficient, how can you help them to build their capacity?
- > How much resource can you devote to social impact management? Is it costed in your business model?
- > How will you collect and verify data/information?
- > What is your timeline for outcomes and impact measurement?
- > How will you make sure social impact data and analysis are feeding in to your investment process and strategy?



Exercise 4. What do I need to consider when creating a social impact management plan for social investment?

Have you considered...?	Answer
For setting objectives	
What are the key objectives?	
What are the expected outputs and outcomes?	
For stakeholder analysis	
Which stakeholder groups will you engage with and analyse?	
How will you capture the impact on stakeholders other than beneficiaries?	
For choosing a social impact measurement methodology	
What are your investee(s)' information needs?	
What are your investee(s)' capacity and resources?	
What is the complexity of the social issue? Who else might have invested in it?	
What are your own resources?	
Where will you focus in terms of the impact value chain?	
Will you use standardised or bespoke indicators?	

For verification and validation	
Will you use benchmarking?	
What will you do if there aren't any benchmarks?	
How will you ensure validation by stakeholders?	
How will you take the impact of other investors or intermediaries into account?	
For monitoring and reporting	
What is your monitoring time frame?	
How you will record, process and aggregate the data?	
Who needs to know about your results and how often?	
What are the best ways of communicating impact information?	
What are the implications of social impact data for your investment process?	

Chapter 7

Consider if scaling is right for you

The way forward following a successful pilot

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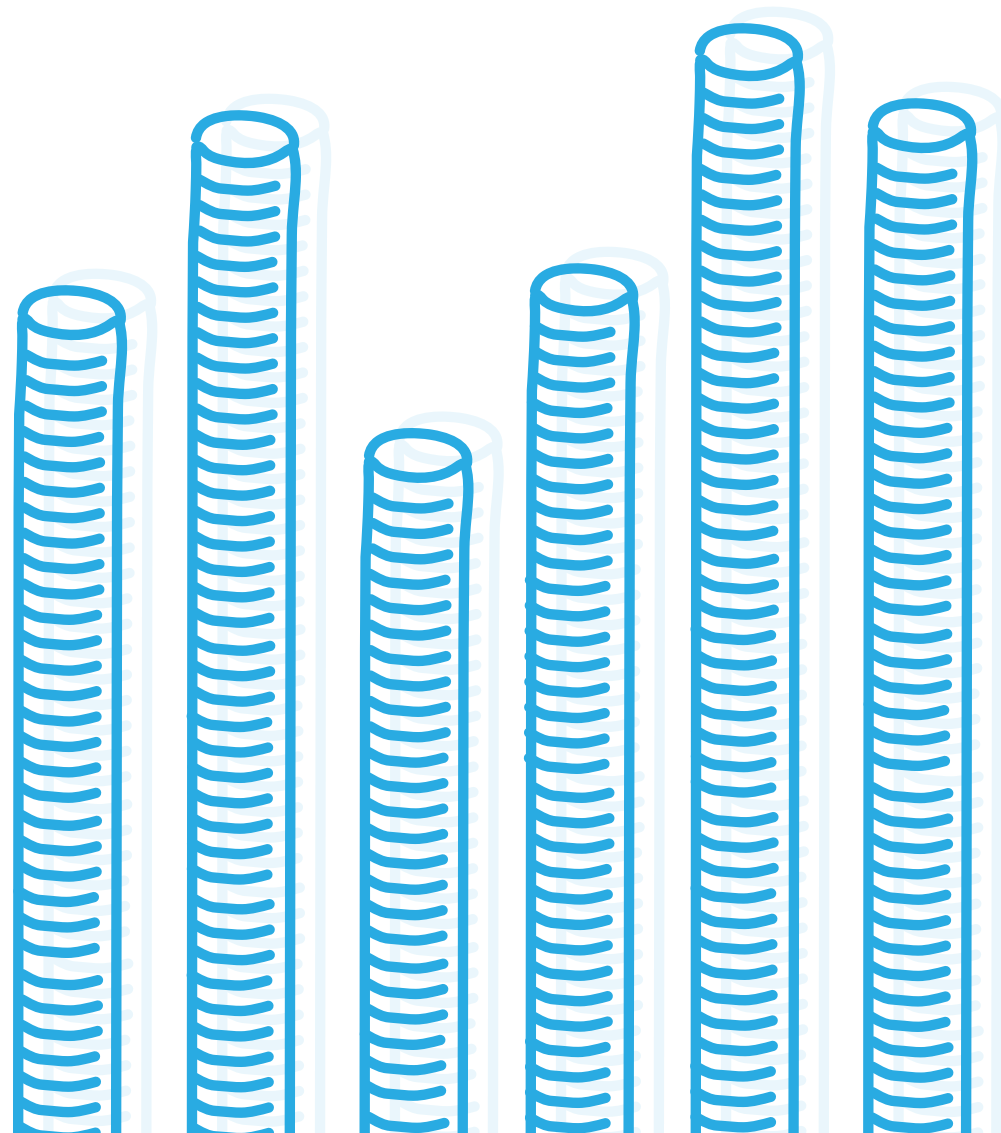
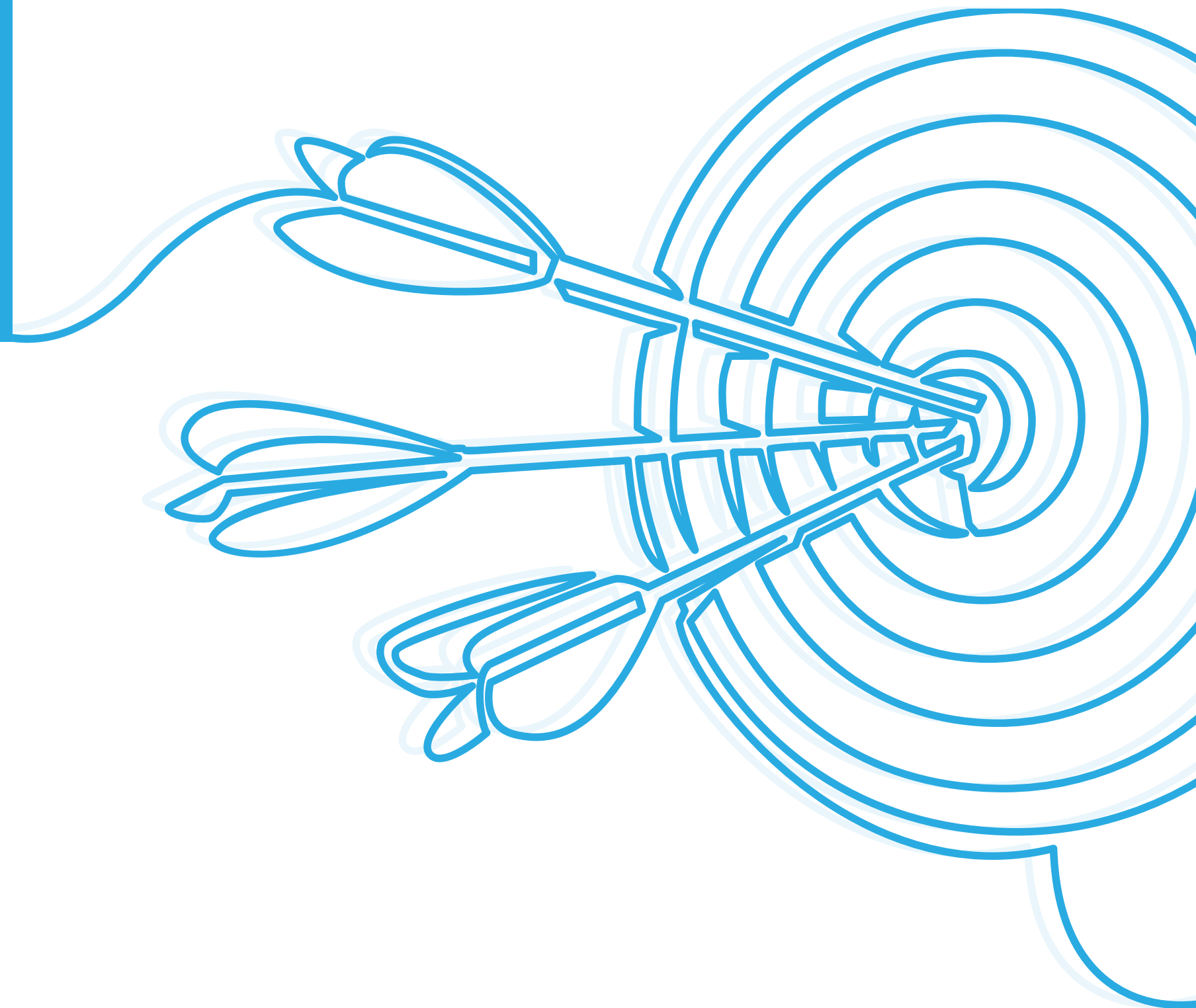
Learning objectives

On completion of this chapter, whether you are an investor or a support organisation, you should be able to:

- > understand what scaling means to you;
- > have a sense of the difference between scaling impact and scaling the business;
- > know the prerequisites to scaling and whether you are at that point;
- > consider the alternatives to scaling.

At this point, you should ideally have the following in place:

- > social impact objectives and goals;
- > an impact management system;
- > an assessment of how your social impact management affects your business model;
- > an evaluation of your impact from the pilot.



7.1. Scaling

7.1.1. What do we mean by scale?

Economic theory teaches us about ‘economies of scale’. The industrial economy was all about scale: once a company developed a winning product, the challenge was to increase production as much as possible in order to increase savings (and maximise profit). This lowered unit costs and allowed firms to undercut rivals, thereby gaining market share and more scale and so locking in their market leadership. Mass marketing, mass production, mass distribution: investment was aimed at maximising scale and business hierarchies were organised in a way that made this possible. Is this what we mean by ‘scale’?

Policymakers, investors, intermediaries, and even social enterprises themselves eulogise about ‘going to scale’ but it is often very unclear what they actually mean. Do we just mean growing to increase our impact? If we expand our operations, are we going to scale? We have found it helpful to consider the independent definition from the Oxford English Dictionary.

The Oxford English Dictionary defines ‘to scale’ as ‘to reduce or increase in size according to a common scale’. You can **scale** something **up**, but you can also

scale something **back**. We suggest that this comes about by a deliberate action or actions and is different to organic growth or decline. We then understood that **scale** is being used increasingly as shorthand for scale up in the sense of growing or expanding in a proportional and usually profitable way. If you are a for-private-profit company, the prerequisite is greater profit. For social enterprise and social investment, the prerequisite is greater impact (to the point where, once it has expanded to its optimum level, it’s a self-sustaining model) ⁽¹³⁰⁾.

In 2012, Weber, Kroger and Lambrich argued that ‘scaling is defined as the most effective and efficient way to increase a social enterprise’s social impact, based on its operational model, to satisfy the demand for relevant products and/or services’ ⁽¹³¹⁾.

In this chapter, the focus is not on scaling (up/back) organisations themselves, but on what an investor or a support organisation can do to scale its own impact. The relevance of the technologies of the cloud and AI is also touched upon ⁽¹³²⁾.

7.1.2. Why does scale matter?

The needs that social enterprises and the wider third sector seek to meet are enormous. Demographic changes, reductions in public sector support, the consequences of climate change, and social and technological innovation are but a handful of factors increasing these needs. So, if you are successful in tackling a social challenge at a certain level – whether as an investor or an intermediary/support organisation – you are likely to find yourself wanting to optimise this (i.e. to do more) and/or being put under pressure to do so. You may have decided that it is the obvious next step

in delivering your vision. You may have planned it all along, but scaling can also be the result of peer pressure or pressure from other stakeholders who are keen to use you to fulfil political aims, such as lowering unemployment or reaching greater numbers of marginalised people. Remember that you do not have to scale. In the example of Social Enterprise NL’s Next Level Programme (see Section 4.5.1.4.), they decided not to do so.

Inevitably, scale will mean different things to different people. It may mean simply increasing the scope of your activity to work in neighbouring communities, but it can also mean substantively increasing your involvement or deepening your engagement with issues such as those presented by the UN SDGs. Scale can also mean doing more with less and/or becoming more effective. It can be achieved in differing ways, depending on how suboptimal your performance has been so far.

7.1.3. What are you scaling?

How should you decide whether going to scale is the next step? Go back to your blueprint and the adjustments you have made: *Do they still hold true?* With a few exceptions, the social enterprise market and third sector are essentially comprised of ‘cottage’ enterprises – thousands and thousands of initiatives, each operating in a single community and often in isolation. This may be appropriate, but in many cases it may represent a substantial loss to society. However, it could also mean that, as constituted at present, many of those initiatives are not scalable.

Fundamentally, you must be clear as to whether you are scaling your organisation or your impact or, just possibly, both. It does not follow automatically that scaling the size of your business will increase your impact ⁽¹³⁴⁾. Indeed, it is quite possible that switching management focus to scaling an organisation may lead to a dip in impact. The answer should lie in the values and vision outlined in your blueprint. You should consider scaling your organisation in the way that best allows you to realise your intended purpose and fulfil your mission. And, you should only scale what works

Much of the literature about scale is directed at social enterprises, some of which is included in the References at the end of this guide, should you wish to dive deeper. There are also several scholarly articles on scaling investment in social enterprise ⁽¹³³⁾.

at scale. As an investor, you will apply strategic planning to the long-term success of your strategy and ensure it’s in harmony with your vision. You will also apply this thinking to your portfolio. This may encourage you to make changes in your portfolio to optimise not only their but also your own impact. If you are a support organisation, you will also have a long-term strategy which may cause you not necessarily to work with as many social enterprises as you can, but to work with those that may be nearer to optimal delivery and therefore able to deliver greater impact themselves and for you; for example, where the enterprise model is established and the market proven so that many more target beneficiaries can be reached.

Global full-service management consultancy A. T. Kearney has developed a social enterprise accelerator model, a pyramid of key factors that progressively help social enterprises to scale up. The foundation layer is ‘clear vision and mission’ ⁽¹³⁵⁾. This applies equally to investors and support organisations.

130 Bruck (2006).
131 Weber et al. (2012).
132 If you are interested in further exploring how technology is turning scale economies on their head, see Taneja and Maney (2018).

133 Dees and Battle Anderson (2004); Rotheroe and Richards (2007).
134 In 2017, two major financial fund managers, Aberdeen Asset Management and Standard Life, announced their merger to create a ‘formidable player’ on the global money-management stage. Within 6 months its major client had withdrawn, and the business was plagued by disappointing performance (MoneyWeek, 2018). Equally, in the social enterprise sector, one of the UK’s largest housing associations merged with a neighbouring association. A side effect has been the selling-off of social housing in high-value inner city areas (where it is desperately needed) to fund new developments in lower cost areas, sometimes on the open market, resulting in detrimental impact.
135 Kearney (2015)

7.1.4. What does scale mean to an investor?

If you are an investor, scale could mean:

- increasing your social return on investment (SROI) (i.e. getting more social value out of your investments);
- optimising your investment behaviour to deliver optimum social impact through your portfolio.

You can achieve this by:

- increasing your investment directly, or by increasing the amount you invest through a fund or funds;
- increasing your investment indirectly, for example through a fund or funds; replication in other markets (here you will need to have researched the culture and regulatory environment of the new market fully);
- investing in innovation not for innovation's sake, but to ensure the products you are investing in are compelling, sustainable and meet the needs of the target market not only in terms of the product but also reach and reliability of service;
- investing in franchises where the concept is proven and the business model is successful and capable of operating at scale;
- investing in replication by backing something that works and financing its replication in other markets (here you will need to have researched the culture and regulatory environment of the new market fully);
- investing in people, for example leaders who are strategic thinkers themselves and can help you fulfil your mission at scale.

Are you a one-off investor who was attracted to a particular enterprise or a mission? If you have limited resources available, you can still scale your impact by partnering with other investors so that you can pool patient capital, debt, hybrid financing or even equity so that the right types of funds are matched to the right stage of the enterprise's development.

Such options are improved by the presence of intermediaries and support organisations.

7.1.5. What does scale mean to an intermediary or support organisation?

If you are an intermediary or a support organisation, scale can mean a number of things, inter alia:

- reaching more social enterprises;
- working with a portfolio of enterprises most likely to reach scale themselves.
- providing deeper support;

You can achieve this in a number of ways, such as the following.

- Entering new sectors and/or geographic markets. This could be the next village, the whole country or across the border.
- Franchising your own model to reach more scalable enterprises and markets.
- Partnering with like-minded organisations. Intermediaries can play an important role in scaling strategies by serving needs that extend beyond the capacity of any one provider. The Microfinance Information Exchange (MIX), for example, supplies detailed financial and social performance data about microfinance institutions to potential investors and to the institutions themselves. In more developed markets, field-building support organisations are emerging and action-oriented collaboratives are on the rise.
- Working with enterprises to develop models that enable both you and them to deliver at scale. Many organisations are using the internet to expand their impact without increasing their physical presence. These are known as 'bricks-to-clicks models'; they create toolkits and platforms that users can readily adopt.
- Matchmaking to deliver more value to investors.
- Social media can also help you scale impact through knowledge sharing, network building, campaigns and collaborations. Social marketing techniques can bring about widespread change by altering people's perceptions of what is acceptable. You can also scale impact by changing people's notions of what is possible. In microfinance, for example, not-for-profits encouraged some companies to invest in unrecognised, bottom-of-the-pyramid market segments. Some of these are now creating self-sustaining markets among people they previously had no desire to reach.
- Investing in, leveraging or using technology to reach more enterprises and consumers. Like the enterprises themselves, it is quite possible that successful support organisations will become virtual, global and cloud-backed organisations that have transformed their fixed capital costs to operating expenses. Technology can also help them scale up repetitive activities.

NEW TECHNOLOGIES: A LEVER FOR GREATER SOCIAL IMPACT?

Technology is rapidly changing the environment in which social enterprises and support organisations operate. It enables social enterprises and intermediaries to move beyond their local geographic areas and generate greater impact by scaling easily replicable activities with lower unit costs in traditionally underserved areas. Social enterprises and support organisations can also use technologies to rethink and disrupt conventional business models. This creates both opportunities and challenges.

Opportunities

- Ability to foster networks across sectors while facilitating easier and faster knowledge transfer and allowing for greater communication and coordination;
- Leverage of assets across different regions and fundraising through online platforms and crowdfunding;
- Services (and goods) can be produced in a more efficient, just-in-time and cost-efficient way;
- Ability to overcome distance barriers and adopt a more expansive notion of community;
- Social enterprises can hone their skills by learning from others online;
- Governance can be more transparent and participatory by including stakeholders regardless of location.

Challenges

- Digital divides owing to limited access to broadband in some areas;
- Some users lacking technical know-how in terms of harnessing all the benefits of information technology;
- Risk of diluting the ‘social dimension’ and face-to-face contact ⁽¹³⁶⁾.

7.1.6. How do you decide whether to scale?

Whatever path you take, you will need to ensure that your organisation is resilient and ready to scale. Whether you are an investor or a support organisation, ask yourself the following questions.

136 Organisation for Economic Co-operation and Development (2016).

- **What further changes will scale bring?** In the example in Annex 3, Investors in Society had to change its structure to transition from being a social investment fund to a regulated values-based bank so that it could upscale its business.
- **Can you increase the number of social enterprises you work with, without lowering the volume or quality of your support?**
- **Is the talent pool deep enough for you to recruit the people you will need? If you have one, will you be able to increase your pro bono professional (mentor) network?**
- **Will you be able to continue to offer seed funding, if that’s part of your support model?**
- **Are your systems robust enough to support scale? What will scale do for your mission and for you?**
- **Are you the right person to take the enterprise to the next level?**
- **Do you need to introduce a new form of management and governance structure?**
- **Will your team upscale with you? Many co-workers are often happy with the status quo and may resist change.**
- **Will there be cultural differences to assimilate if you cross borders? Are there legal constraints to working across borders?**
- **Can you fund the additional costs of your growth? Is the financial life cycle long enough to finance even greater scale? What are the financing options?**
- **Are your underlying economics, meaning costs as well as revenues, transparent?** If you continually ‘live on the edge’, or cannot articulate the cost of your theory of change, you are not best placed to go to scale.
- **Should you go to scale, or should you encourage replication, possibly through a franchise model?** Adopting a proven model may make it easier to attract resources. The more complex your theory of change, the more difficult it will be to replicate what you do.

But if you do go to scale:

- > you will be able to optimise the impact of your model;
- > you may benefit from being part of a larger network where you can share resources and operating procedures and become more impactful;
- > you may mitigate your current market concentration risks and/or reduce your dependency on political or monopsony ⁽¹³⁷⁾ risk;
- > you can produce greater outcomes, probably with more certainty, at a faster pace;
- > you may demonstrate impact on a larger scale, which can help you create greater visibility and attract additional resources;
- > you may help solve some of society’s challenges.

137 When a large buyer (not seller) controls a large proportion of the market and drives the prices down. Sometimes it is referred to as the buyer’s monopoly. Source: Investopedia (n.d.a).

EXAMPLE: GROWTH FINANCE TO EXPAND CLEARLYSO'S ABILITY TO RAISE CAPITAL

ClearlySo is a UK-based financial services firm founded by an American former investment bank analyst in 2008. It is a classic intermediary and specialises in social impact investment, providing capital raising and advisory services to funds and entrepreneurs generating social and environmental value. ClearlySo also helps investors discover innovative opportunities to make social and financial returns. It has been a certified B Corporation since 2015.

Since it was founded in 2008, ClearlySo has scaled in both scope and impact. In 2012, it was approved as one of the first ICRF providers (see Section 6.4.), and, in the same year, it launched the *ClearlySo Guide for the Ambitious Social Entrepreneur*, a mine of freely accessible information for anyone with an interest in social enterprise. ClearlySo also started the first UK-dedicated social impact angel investor group, CSA, in 2012 and manages investor relationships with institutional investors, including foundations, impact investment funds, banks and corporations. In 2013, the firm was announced as the investment partner for the BVC, a 3-year programme designed to address the funding gap for early-stage/high-risk capital, led by UnLtd and underwritten by the Big Lottery Fund.

The scaling of ClearlySo's impact so far has largely come about through partnerships within the social finance ecosystem, enabling it to work with more high impact enterprises, charities and funds. Each business it engages with must have demonstrable and scalable social or environmental impact as well as embedded impact measurement or at

least a plan for how impact will be measured and reported. Likewise, ClearlySo practises what it preaches and has developed its own strategy for how to continue scaling its impact.

To scale its impact even further, however, ClearlySo requires growth finance. In 2016, it raised GBP 1.25 million from existing and new investors, including Octopus, the largest provider of venture capital trusts in the UK, which took a 12.5 % equity stake. Seven existing investors, including Big Society Capital, reinvested and eight new angel investors subscribed, mostly from ClearlySo's network of high-net-worth individual investors. ClearlySo is using this investment to finance its growth and, as a result, to expand its ability to help more social businesses and enterprises raise the funds they require to grow, scaling not only their but its own impact. To date, ClearlySo has enabled more than GBP 200 million of impact investment to be raised by its clients.

To support this growth and build its credibility, ClearlySo extended its activities into other non-financial support services. It has a research capability that undertakes commissions for both public and private sector clients, and is contracted to provide services to third parties such as the Childcare Investment Readiness Fund. In 2016, it launched ClearlySo Atlas⁽¹³⁸⁾ to help private equity and venture capital investors assess the social and environmental impact of their investments and provide practical suggestions for action. The results are mapped to the UN SDGs.

138 ClearlySo (n.d.c).

EXAMPLE: ACHIEVING SCALE THROUGH CHANGING THE LEGAL FORM

As an investor, you may need to change your legal form if you move into a different regulatory environment in order to scale up your mission and impact. Similarly, it is not unusual for enterprises to decide that they can more effectively deliver their mission via a different legal form. Many entrepreneurs and investors believe that if you set an organisation up with a tax privileged status it has to stay that way, but that is not the case. While you cannot change the amount of money that is tax privileged, you can 'swap' it. For example, if an NGO becomes a for-private-profit company, the tax privileged amount typically gets hived up into a charitable foundation (which could then reinvest in the company if it has retained charitable objects, for example, if it is a B Corporation). This is one way that private healthcare companies move into newly opened up markets through the acquisition of NGOs and market share. It is also a simplistic version of what Charity Bank had to do when the European regulators determined that charitable capital could no longer be accepted as core banking capital.

One case study of achieving scale through changing legal form is hi-tech entrepreneur Jim Fruchterman. In 1989, Fruchterman founded a non-profit company, Arkenstone, in Palo Alto, California, to provide reading machines for blind people. Over the next 11 years, Arkenstone sold over 35 000 machines in 60 countries, reading 12 different languages. However, in 2000, Arkenstone felt that it had gone as far as it could and wanted to reinvigorate its mission and vision and scale its impact. It sold the machine product line to a for-profit company. The company rebranded the non-profit as Benetech and, with the funding from the asset sale, started Bookshare.org (an online library for people with print disabilities), and created the Martus software (a free, open source, secure information collection and management tool). An early co-investor in Martus was the Open Society Institute through its Aspiration initiative due to Martus' unique focus on human rights tracking. As such, Fruchterman and his team decided not to keep scaling Arkenstone and, with the US charity regulators and tax authorities, were able to expand their mission through a recapitalised, Benetech which remains a non-profit⁽¹³⁹⁾.

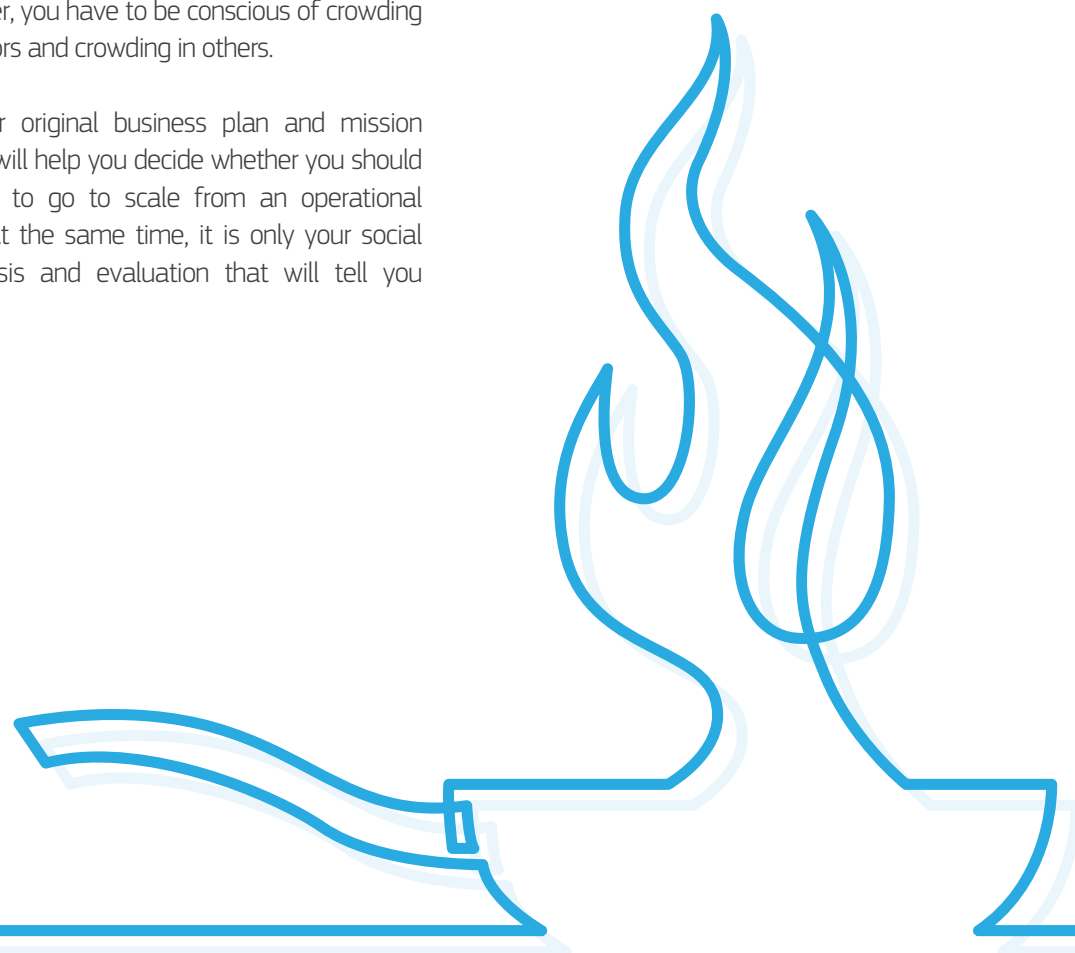
139 Benetech (n.d.).

The approaches showcased in this section are all about scaling impact, rarely – if at all – about scaling organisations. However, successful scaling will nearly always depend on the existence of a strong organisation, be that an intermediary support organisation, a social enterprise or an investor. For them, their reason to be strong and why they are strong is that their mission is central to everything they do.

If you want to achieve impact at scale, your investment and strategies will have to focus on both the systems and the organisation itself. Systems change requires healthy and adaptive organisations that can respond to opportunities and challenges in new ways. These may require new forms of organisation (such as platforms, backbones or market facilitators). There will also be a need for more co-creative processes that engage with communities in devising solutions. In so doing, however, you have to be conscious of crowding out some actors and crowding in others.

Checking your original business plan and mission assumptions will help you decide whether you should and are able to go to scale from an operational perspective. At the same time, it is only your social impact analysis and evaluation that will tell you

whether your initiative is delivering the outcomes and impact that will make it worthwhile to go to scale. Quite often a pilot, which may run for only 18 months to 2 years, will not be able to give you a full response to the question ‘should I go to scale?’ In such cases, look at the market demand and uptake of your offer during the pilot phase. ***Does it look like there is need for your offer and is it likely to continue? Did you manage to get enough organisations interested in order for your initiative to continue?*** If you find that the demand is missing, you should seriously consider concluding your pilot and thinking about what else you can do with your resources.



THE FIELD OF DREAMS: ARE YOU READY TO SCALE?

It's important not get carried away to your 'field of dreams' ⁽¹⁴⁰⁾. In 2018, a Stanford Social Innovation Review (SSIR) article ⁽¹⁴¹⁾ notes that the third sector is rife with examples of enterprises that have failed in their pursuit of the economies of scale. Many remain small despite their best efforts, while others grow in size but fail to grow in impact. The latter dynamic often occurs where enterprises are too quick to move to scaling mode, perhaps encouraged to do so by an investor or a support organisation. Those that did succeed almost always began with establishing whether they were ready to scale: they 'earned the right to scale' as the culmination of a deep, long-term commitment to strategic leadership.

So how do you know which of your portfolio, whether you are an investor or a support organisation, can go to scale? Based on their collective 60 years of research, the SSIR article authors have developed a readiness to scale matrix analytical tool that can help you understand whether you (or your portfolio) are ready to scale impact, and if not, why not. An online diagnostic tool is also available ⁽¹⁴²⁾. The matrix has two axes that correspond to strategic thinking and strategic management. How the organisation scores determines which of five categories the organisation will fall into. Each category aligns with a specific level of investment readiness.

In the SSIR study, 37 % of organisations found themselves in **scale jail**, neither able nor ready to scale their impact in the foreseeable future because they have mastered neither strategic thinking nor strategic management. 15 % found themselves on the cusp of the **waterfall**: while they excelled at generating resources, they could not build an impact model that would justify investment. They need to understand strategic thinking before investing in expanding. Some enterprises (10 % in the sample) provide a service locally or to one small target population and are exactly as large as they should be. They must ignore pressure to be something they are not. To them small is beautiful. Others have a well-built engine but need to generate certain types of fuel to scale their impact, whether through recruiting talent, mastering board governance or strengthening the 'G' in ESG (environmental, social and governance criteria). 27 % were in the **field of dreams**. Only 11 % had mastered the components of strategic thinking and management to reach the **promised land**. Having got there, they now need to continue to be diligent in performing at this level.

So, take a look at your portfolio, at your own organisation and your ambitions, and remember that more than 50 % of your enterprises may be stuck in jail or on the edge of the waterfall, and that only just over 1 in 10 can successfully scale their impact. But by working on strategic management skills, those percentages can change. This is therefore an area of focus for investors and intermediaries alike.

140 The 'field of dreams' concept comes from the 1989 American fantasy-drama sports film of the same name.

141 Meehan and Jonker (2018).

142 Engine of Impact (n.d.).

7.1.7. The impact of technology on scale

In the wider economy, technology has lowered the minimum efficient scale of production to a point that is within reach of most SMEs; however, for companies with a monolithic business structure, this causes diseconomies of scale to kick in sooner in a more material way. AI is also having a profound effect on scale. AI makes it possible to know what each customer wants so that product and service can be tailored for everyone. But many established firms have legacy systems onto which they simply bolt such apps. In the long run or even the short term, such an approach is fraught with problems ⁽¹⁴³⁾.

Technology is also impacting the scale of businesses from conception. New business models are emerging based around the size of the demographic an enterprise wishes to serve and the number of products or services it offers ⁽¹⁴⁴⁾. One model that social enterprises and social investors use is known as the ‘unbundled start-up’. They spot a niche: perhaps the products or service was not offered before; the demographic is un- or under-served; they can offer a more personal service; they can combine technological and design thinking. This is an unscaled model that uses cloud infrastructure to operate at low volumes and uses AI to serve small segments of the market and so maximise the potential impact. In some cases, the scale of the solution leads to the enterprise becoming a large one itself.

7.2. Alternatives to scaling

Scaling does not always follow the pilot stage in the life cycle of financial investors or intermediaries. Evaluating your pilot and answering the questions in Section 7.1.6. about scaling potential may lead you to decide that you are not yet ready to go to scale or that there are not yet enough enterprises in your portfolio to warrant such a move.

This is also fine. You can choose to continue working with those organisations to enable them to scale provided that you have sufficient resources to continue your involvement. You may also decide to reshape your portfolio, exit from some or all of your investments, or you may choose to retain a mixed portfolio to spread your risk.

7.2.1. Exit

Here, the term ‘exit’ refers to the strategy that investors use to ‘cash out’ of an investment made in the past. This may be necessary to get out of a non-performing investment or, on the contrary, when the investment meets its objectives. Exiting an equity investment can involve selling shares to a buyer or an initial public offering (IPO), while exiting a loan might simply occur when it is repaid or if it is written off as a bad debt. Plenty has been written about exiting social impact investments, including the challenges and opportunities on both the investor and investee side. In this section, the focus is on exit solely as an alternative to scaling, and exit strategies and methodologies will not be discussed in detail.

social mission and they take place at a time that is best for everyone. If your investment was socially motivated, the exit should not be motivated simply by financial return. When you perform your due diligence to invest, also take time to think about your exit strategies up front. Transparency will help your investee too. Sometimes the values or missions of the original investor and the new buyer are not aligned. The consequences of this may be many, not just for the customers, but also for the company, employees and even the ecosystem within which it operates. Be aware also that some social enterprises may be acquired simply to be shut down to remove the competition.

You may decide to exit your investments or close your fund altogether, however exiting an unquoted investment may be challenging, particularly as secondary markets are underdeveloped or non-existent in most countries. At the same time, some of the early impact investment vehicles’ investment horizons are now coming to an end, so there could be a depressive effect upon pricing ⁽¹⁴⁵⁾. **Responsible exits** support the preservation of the investee’s

A number of ways have developed to return capital to investors without an IPO or sale, especially where the entrepreneurs wish to maintain control over their enterprise or have philosophical objections to the way public markets operate. In some cases, albeit rare, the social investor may have a buy-back arrangement with the entrepreneur. Again, this might help to shape your strategy.

143 In 2018, TSB Bank in the UK tried to upgrade its IT system to make it more user friendly. The upgrade was unsuccessful and the bank lost eight times more customers than usual.

144 Robinson (2018).

145 It is increasingly common for investment vehicles to be set up as closed-end or fixed-term funds. If you have to return cash to investors at the end of 10 years, for example, it is likely to mean that you will be seeking to exit your investments from, say, year seven on. As more funds mature, the supply of investments to be repaid or refinanced will increase. If demand does not increase at the same rate, it can depress the resale value of these investments.

7.2.2. Closure

As an investor, you may also decide that the time has come to reduce your involvement or exit altogether. This could be for any number of reasons, such as:

- when a market has been proven viable and starts to attract mainstream capital, early social investors may 'declare victory and go home', or may go back to the beginning and renew their engagement;
- your investment strategy may change (for example, you may decide to switch your focus);
- you may have a need for liquidity, or a higher priority opportunity has arisen elsewhere;
- the enabling environment of a particular market may have changed and you could consider your investment exposed to greater risk.

If you are an intermediary or support organisation, you may decide to close your business or programme, even after a successful pilot, or just sustain it at the original level. There could be several reasons for this, such as:

- you may not have enough resources to scale;
- there may not be enough demand for your services;
- the environment or the market may have changed and made your service offer unnecessary;
- competitors or other actors (for example governments) may have launched similar programmes, made them available for free or included them in mainstream programmes, which could squeeze you out of the market.

Your summary questions for Chapter 7:

- > What are you scaling?
- > Are you ready to scale?
- > If not, what do you need to get there?
- > Have you considered your alternatives?
- > How do these alternatives impact your vision?



Chapter 8

**Food for thought:
Learn from your experience
and establish a way forward**

Looking to the future

> 8.1. Recap of what we have covered in this guide	200
> 8.2. Scanning the horizon	203
> 8.3. Practical recommendations	206

Learning objectives

On completion of this chapter, you should be able to:

- > understand learnings from the chapters and examples in this guide;
- > be able to look back and establish the learnings in terms of your own initiative;
- > be able to look forward and plan for the future.

At this point, you should ideally have the following in place:

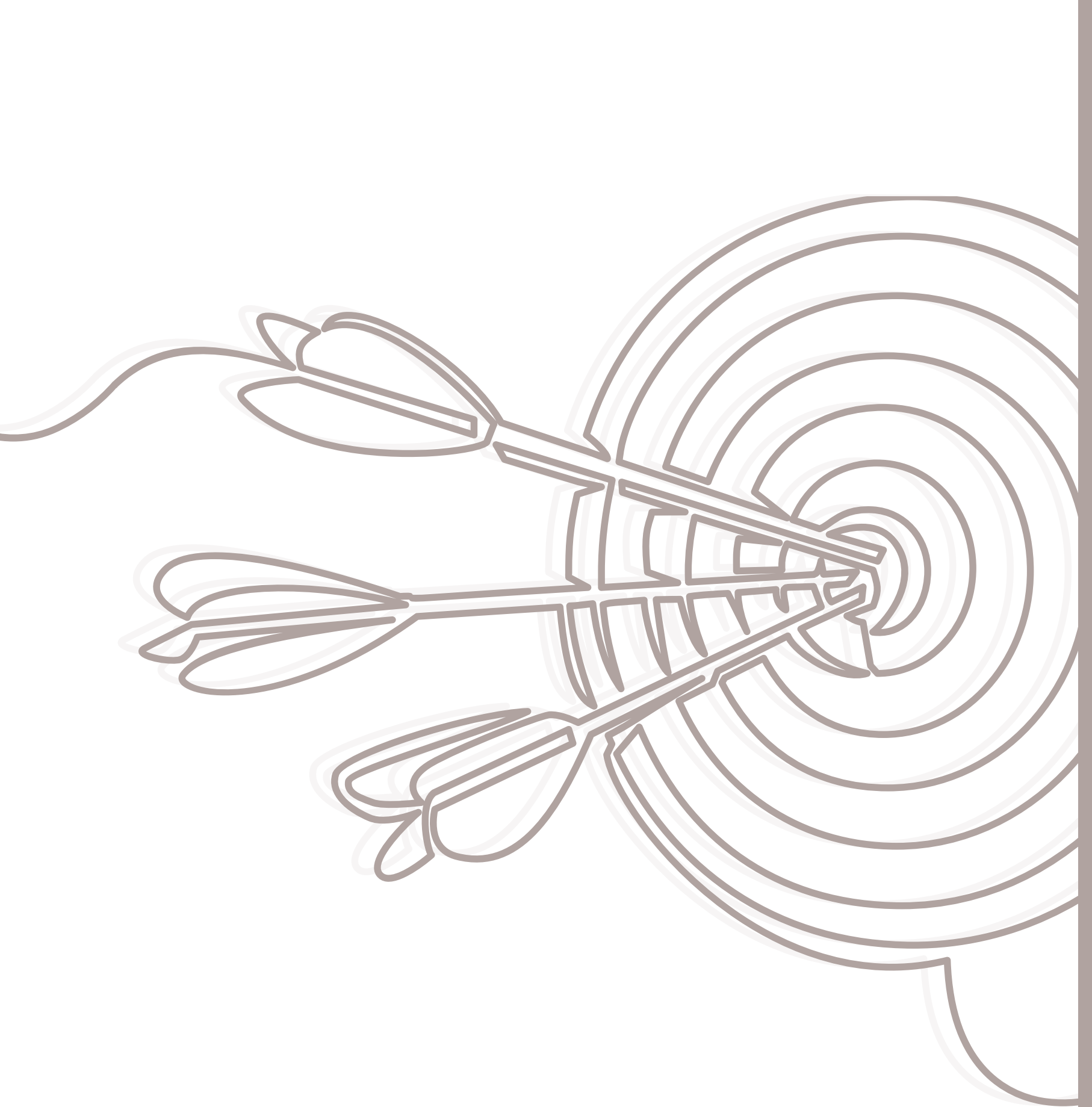
- > a completed and validated investment or intervention model (financial instrument or capacity building/support programme);
- > a decision and plan for scaling or alternatives;
- > resources for scaling or another next stage.

We hope that this Recipe Book has served to give you a sense of how you can engage in developing your taste buds, as well as those of the market, in terms of social finance and non-financial support measures, whether you are an institution, a company, an organisation or an individual. Sensitivity to such flavours can serve to heighten your awareness of, and interest in, helping to shape the financial ecosystem in your region or town, or – more broadly – in writing your own recipe for a very different type of social enterprise where traditional concepts of financial risk/reward are replaced by a multiple bottom line.

The EU-funded pilot initiatives have shown us what is happening in some countries in the EU; some are very new to such thinking, others have

a longer track record of innovation in the social finance area. They have also warned us about how to measure success and about some of the hurdles that still have to be overcome. If social finance is a dish best created and served over time, then we have similarly learnt that achieving scale cannot be rushed.

Today, outside of government intervention at EU, regional or national levels, the social finance market is dominated by values-based banks, trusts, foundations and specialised funds. But there is also an upwelling of interest from individuals, often through intermediaries and the cloud, and by social enterprises investing in other social enterprises.



8.1. Recap of what we have covered in this guide

In the Introduction and Chapter 1, we tried to get to grips with key definitions that occur time and time again, so that you would know a social enterprise or fellow social investor when you saw one. We also indicated in these definitions what we believe social finance to mean. We hope that you found enough of the basic ingredients here to progress to Chapter 2 and to begin to articulate your vision and to steer yourself along a financial or non-financial path, or maybe to merge the two.

Chapter 3 looked at the options for the variety of ways in which you can engage as a financial investor, while Chapter 4 focused on engagement as a non-financial investor. Chapter 5 addressed the pilot stage of development of your initiative, while Chapter 6 helped you think about how to know if your efforts are successful and how to relate back to your original vision. In Chapter 7, we explored how you might scale your impact and provided pointers as to when you will know whether you are ready to scale. We also touched on alternatives should you prefer not to scale.



There is no one tried-and-tested formula or recipe for social finance. There are challenges at whatever level you operate, but you can find good examples and practices that can offer learning and that can be adopted with variations. The key messages are summarised below.

- It is fundamental to **go through the basic logic process before you launch a social investment initiative** or when you are redesigning an existing one. The six steps of assessment – vision, financial investment strategy, non-financial support provision, pilot, impact and evaluation – form a sequence, but they should be steps in a cycle, providing constant feedback and opportunity for recalibration. The seventh step – scaling – requires additional commitment and deeper strategic thinking and management.
- The **process is time consuming**, as it may involve awareness raising, education, cultural change and many different stakeholders. The social investment markets are very young in most countries and should be allowed the time and resource to evolve, probably in very different ways. If something is not happening in a community or perhaps has been tried and abandoned, investigate why.
- **Define it before you do it.** No two definitions of ‘good’ investing are likely to be the same and every investor will have a unique perception of what it means to them. Each investor will need to determine what is ‘correct’ for them based on their individual values and priorities.
- But also **temper idealism with realism**. Target an appropriate level of risk consistent with achieving your investment goals and whether or not you wish to be diversified across a range of instruments.
- **Investor vision and goals have to be the basis of the investment strategy.** No meaningful evaluation of social and financial impact can be performed without them.
- Don’t let your vision and goals be obscured by predetermined models of business form, theories of finance and risk. **Social enterprise offers a values-led theory of change rather than a market-led one**, but many of the financial instruments available to them are rooted in neoclassical market concepts. This can give rise to the tensions that exist between investor appetite and entrepreneurial expectation. If social entrepreneurs are working differently and developing new models of enterprise, they have a right to expect investors to at least think similarly. Failing that, old models of mainstream finance will predominate.
- **Social finance packages must respond to the needs and goals of the social enterprise**, so it is critical to identify those before making an investment. This is not only about the interest rate. The choice of financial instrument and complementary non-financial support should correspond to the stage of development of the enterprise and should be flexible. They should take into account that social enterprises create value through their social and/or environmental impact, not through profit maximisation. The greatest unmet need is in small-scale, simple amounts of builder finance and for investors/funders to collaborate to provide relatively seamless access to life cycle finance. If you are making social investments, how social are they?
- **Doing well by doing good is not doing enough to transform finance.** Put another way, who pays for the social impact in impact investing? Mainstream impact investment models can reinforce inequality in the pursuit of social impact and market rate returns. The cost of impact is often passed on to the entrepreneur through the extra time taken, for example, to train and employ youth, hire and promote ex-offenders and create inclusionary workplaces.

- **The investor's risk appetite, in terms of both social and financial return, will be a key consideration in the investment strategy**, so investors should be honest and articulate their expectations. If you are lucky, you might find other investors that sit at different points of the investment spectrum, so co-investment will be a way to spread your risk and gain higher returns. For the most part, though, social investing is not a high financial return business.
- **Intermediaries are natural partners to investors: collaboration with and support for them** also enhances the performance of social enterprises and reduces mission drift and financial risk. Intermediaries are also instrumental in bringing different actors of the market around the table. At the same time, they increase transaction costs, which may eat into any viable business model.
- **Focus on early-stage social enterprises is critical**, even though they are risky, because they will generate the pipeline for social investors. Support organisations should continue to focus on this segment and not fall for the temptation of switching to growth or scaling social enterprises completely, even if pressed by their sustainability concerns. However, **it is important that there is support and investment available at all stages** along the way so that enterprises are not set up to fail through lack of life cycle finance and support at a later stage. Do not assume that all your early-stage enterprises will go on to feed your pipeline, though. Some will stay small and still create impact. Others will find their model is more attuned to grants or interest-free money. Some will fail.
- **Pilot your initiative before rolling it out**. This may lengthen the process, but it is worth your while as it allows you to incorporate learnings into the model or decide to stop the initiative. It's important to listen to customer and other stakeholder feedback, learning from everything and admitting failure.
- **It may not be possible to evaluate the social impact of your pilot in the short term**, but this does not mean that you can forget about it. Implementing a simple system with a few indicators can provide vital information about the predicted success of the model or the necessary modifications.
- When deciding on your social impact management system, it is important to think through the basic logic; do not focus only on the measurement indicators. **Evidence of impact needs to serve the social enterprise. Impact needs to become part of your investment/intervention process and be factored in to the return expectations from the start.**
- **Don't let definitions get in the way of what you want to do**. Social enterprises and their legal forms continue to develop; some don't even think of themselves as social enterprises. Well-intentioned designations of what social enterprise is and what, therefore, qualifies for certain types of funding can end up being exclusive.

8.2. Scanning the horizon – things to look out for as you develop your culinary skills

Enter the individual investors, while pension funds were waiting: The social finance ecosystem is continually evolving as new entrants join the market. After values-based banks and trusts and foundations, there is an expectation that pension funds will be the next big class of social investor. This is only just starting to happen and, more often than not, new, institutional investors step in as participants in large-scale impact investment funds. Under regulations published in 2018, for example, UK pension-fund trustees will be required to produce a policy that includes an assessment of the sustainability of their investment decisions ⁽¹⁴⁶⁾.

Ahead of that, private individuals have begun to increase their presence in the market. This has a number of drivers. Crowdfunding and community shares are beginning to make social investment available in retail-sized chunks while allowing investors to spread their risk across a number of investments. Platforms are also creating a greater awareness of what is going on and where investment opportunities and needs exist, within and beyond your own community. Tax relief or other incentives can encourage some who can compensate for lower financial returns or greater risk (or both) through tax breaks on their income. It may also be because individuals can make decisions more quickly; they do not need to seek a consensus or committee or investment advisor approval. The crowd approach can also reduce the cost of due diligence, making it economically viable to make small-scale, riskier investments while also spreading the risk among more investors.

Social investment submerged in the tsunami of impact investing: As impact investment becomes more mainstream with its mission to prove

that 'financial return need not be sacrificed at the altar of social return', there is a risk that social investment, particularly in modest amounts on the right terms for start-up and emerging social enterprises, will get lost. A side effect of the success of fossil fuels divestment is that there is now a large amount of institutional money looking for a home. To evidence their newly green credentials, fund managers are drawn to impact investing, especially if it can meet their investment return criteria. In such circumstances, there is a need for investors to stay true to their values and strategic vision and not be swayed by siren voices, and for enterprises to ensure that their funders share their values. 99 % of all enterprises in the EU employ fewer than 250 people. The vast majority are independent. They will continue to need small sums: the right amount of money, in the right form, at the right time, from investors who share their values. That is less likely to be found in megafunds.

Financial instruments that address the need to balance social and financial returns: Over the past few years, creative minds have tried to address the essential conflict between social and financial return by creating new corporate forms – L3Cs, CICs, B Corporations – but they tend to favour one side or the other on the investment return spectrum. As a result, the focus is now coming back to financial instruments, as opposed to legal structures, that balance the requirements of social enterprise and social investor. One such instrument, known as FLY paper, is similar to the way in which Google raised funds (see Chapter 3). However, as we saw in the last financial crisis, the more complex the instrument, the less likely we are to understand exactly where the risk lies and whether it is adequately priced.

The impact of technology on social investment:

Digital disruption is the main technological issue in social enterprise boardrooms today, but no more so than in the financial services industry from which many of the practices and tools of finance for social change come. Fintech and techfin are beginning to alter the economics of engagement. The way in which customers want to fulfil their financial needs is changing quickly. Investors will expect to see a similar change in the way they approach social investment. As crowd platforms are already demonstrating, enterprises can reach many more investors than traditional investment rounds and can do so much more cost effectively. Thanks to the internet, they can also reach rural or coastal communities as easily as inner-city ones.

Since 2016, it has also been easier for US social investors to invest in European social enterprise start-ups ⁽¹⁴⁷⁾. Similarly, fintech enables the investor to be physically located in a lower-cost area, where skilled resources may be more readily available. Datasets and award programmes are bringing to the fore social enterprises that are capable of going to scale; cherry-picking these for a digital platform dedicated to social investment can help such enterprises if they are open to a number of small investors. Many social enterprises will produce social returns long before they produce financial returns. In the absence of patient capital from traditional sources, it would be interesting to test the receptivity of the ‘crowd’, including established social enterprises, to such proposals.

2015 might be seen as the year that **AI** became embedded in mainstream thought with the announcement of the Leverhulme Centre for the Future of Intelligence amongst others, and the advent of smart technology in the home. A poll of investment research experts ⁽¹⁴⁸⁾ indicated that automation and economic impact topped the list of risks their businesses were facing, but several spoke of the risk of AI exacerbating or accelerating present-day flaws

in societal structures and pervasive issues. However, altruistic applications of AI are emerging in multiple sectors including education, health, justice and the environment. The UN has projected that AI will play an important role in helping to reach the SDGs. Indeed, a specialised agency for information and communication technologies, International Telecommunications Union (ITU), has compiled examples of AI applications for sustainable development ⁽¹⁴⁹⁾, and there is even an annual AI for Good Global Summit. Meanwhile, Swedish venture capital firm EQT Ventures has developed the Motherbrain, a system that applies algorithms to historical data and online sources to find investable start-ups flying below the radar. Given a fair wind, AI has the capacity to ensure that algorithms reflect our values.

Other major technological buzzwords include **blockchain** (a growing list of records, called blocks, that are linked using cryptography) and **initial coin offerings** (a type of funding using cryptocurrencies). Both can be attractive to social enterprises because entrepreneurs with little track record or even no clear business plan have been able to use them to raise sizable sums. In this context, the ‘coins’ are actually tokens representing, in theory, some claim on the future success of the enterprise. This is different from crowdfunding in that the tokens can be traded on a secondary market. The markets are too small at present to attract institutional investors – who also dislike the legal ambiguity of the tokens – but they can be seen as ‘test beds’ of hypothetical future hybrid financial instruments. On the other hand, while a lot of blockchain activity is motivated by people speculating for profit, or cutting business costs to optimise profit, there is also an emergent ‘blockchain for good’ community. This includes the Blockchain for Social Impact Coalition and the Blockchain For Good think tank.

The European Commission has put out a number of ‘blockchain for social good’ calls. The major categories include: financial inclusion; ethical or transparent supply chains; open government; national e-voting systems; direct democracy systems; securing property rights; humanitarian aid distribution systems; charity donation systems; identity systems; sustainability and climate change; distributed renewable energy; education; healthcare; and decentralised platforms for a collaborative economy. All of these are areas in which social enterprise operates. However, the Principles for Responsible Investment advises a healthy dose of scepticism when assessing many of the projects: ‘many are aspirational in that they are not widely deployed; they address problem areas that do not necessarily require blockchain technology; and they do not necessarily address the problems they claim to solve’ ⁽¹⁵⁰⁾. The value proposition is either phrased in terms of efficiency (i.e. that it will work better) or participatory democracy (i.e. that it will be more inclusive and responsive to people’s needs). However, such uses pose questions of ethics and philosophy, which are unique to the application of blockchain and the investor.

It is inevitable that fintech and AI will play a greater role both in the way social investment develops, and in social enterprises’ operating models. An example is referred to Annex 7. Another example is the Open Banking initiative, which requires major financial services companies to share their financial transaction data with new players in a standard and secure way. This approach has also been adopted within the

European revised Payment Services Directive (PSD2), which allows customers to choose from any reputable third party to manage their banking needs. By increasing the speed and reducing the cost of financial services, AI is expected to extend the provision of financial services to a wider range of people and enterprises. Amazon, for example, can now use PSD2 to get direct access to customer bank accounts in order to instruct credit transfers to load Amazon accounts automatically. This new infrastructure will allow customers to build their own financial services. Given the number of SMEs using Amazon, will social enterprise be far behind?

Culture of trust and collaboration: Some of the new entrants to the financial markets are social enterprises: their language is different to that of the traditional ways of banking and finance. Partly as a result of this, imperfections have developed in the social investment market, whether it has been the missing link between return and risk, divergent expectations of risk and return, a missing secondary market to provide liquidity or a mismatch between sustainable and needed investment sizes. A return to a culture of trust and collaboration is required to manage the complexity of returns that are expected. This will be helped immeasurably by the sharing of common terminology and language amongst investors, service providers and enterprises, and greater transparency, as offered by impact mapping.

147 Following changes in the US regulatory approach to equity crowdfunding, the UK-based European platform Seedrs will bridge the Atlantic.

148 Emerj (2019), formerly TechEmergence.

149 International Telecommunication Union (2019).

150 Scott et al. (2018).

8.3. Practical recommendations

Share experiences and failures: Create a TripAdvisor-style website for social investment ⁽¹⁵¹⁾. After concluding a social finance experience, users could go to the platform and answer the question: What did you think of it? There could be an obligation for all participants to give feedback on what works and what doesn't, why they are finding problems and how and where they are finding solutions. Practitioners need to share a lot more about individual-level experience, whether it is a social enterprise that successfully pitched to a social business angel, a support organisation that runs a successful/sustainable investment-readiness programme or an enterprise that satisfied their investor's financial return needs while retaining control of its mission.

Disseminate research and education across all stakeholders: In drafting the second edition of this guide, we found that a lot of early research has not been followed up or the definitions of baselines have changed. There is also little (if any) evidence that new instruments have been trialled and what the results were. This indicates a huge need for education and research. The social enterprise sector is poorly understood, and there are significant gaps between theory and practice. It has also been argued that the sector is under-researched and that robust evidence of the value of social enterprises' contribution to society remains elusive as management practices, skills and performance and business models are unclear. However, education and research cannot be generic or of a one-size-fits-all nature. They have to be nuanced, reflecting the diversity of the sector. There also needs to be greater dialogue between academics and practitioners as research findings can make a huge contribution to the further development of social outcomes and impact measurement practices. Big Society Capital's *Social Investment Market through a Data Lens research* ⁽¹⁵²⁾ is a welcome early contribution

in this area, but we must resist the temptation to draw broad conclusions from narrow data sets. That said, if we are to advocate the commitment of further resources to social investment, we need to understand its impact and its relevance to the overall social enterprise universe, as well as to society as a whole.

Make further investments into support organisations and intermediaries: Support organisations and intermediaries are a critical part of the social investment chain and, for reasons detailed in Chapters 4 and 5, many of them are struggling to build a sustainable model. More resources need to be available to early-stage social enterprises so they can purchase (or access) the support they need, and more core funding should be provided to intermediaries in order for them to build their own sustainability. Intermediaries should also be encouraged to better measure and communicate their impact. Equally, more collaboration between support organisations and financial investors should help investors understand that non-financial support services are not a cost; they are part of the investment and they contribute to the expected social return. While there is a mismatch between enterprise need and investor economic deal size, intermediaries will struggle to become sustainable.

Provide more support to investors on their social investment journeys: The wealth management business needs to acquire the knowledge, skills and tools to improve client engagement with social investment. This space can seem daunting and raises the question of how an investor can make a social difference. Social enterprise, impact measurement and innovative social finance are three ways that high-net-worth individuals can help address issues of inequality, climate change, geo-strategy, inter-ethnic relations and others. Technology

can help boost this toolbox, for example by reducing the processing cost of information, but advisors need to help the investor combine capital with passion. Encourage social investors to get out and about and meet a broad range of organisations, especially ones located away from capital cities. But equally, we need **greater harmonisation of definitions and tax treatment**. Subsidiarity rules have allowed many European countries to pay lip service to the definition of social enterprise and its tax status. This can be discouraging to investors, especially for investors and enterprises wishing to work across borders.

Play to your strengths: If you are a new investor, stop asking people what they did, in the hope of mimicking their path. You are not them and what worked for them may not work for you: each investor needs to find their own path. Success can come by playing to your strengths, to your values and vision. Figure out what you are uniquely good at, as well as what you are bad at, and then turn your bugs into features. Do what others cannot. Many great social investors have made investments in multiple fields, but most did not get smart in every one at the same time. Pick one sector, spend nearly all your time in it, and become an expert in it. That is how you can differentiate yourself from a more experienced but widely diversified investor. Social entrepreneurs can tell the difference.

Keep financing simple: While innovation in social finance has created valuable opportunities for pioneer organisations, not all social enterprises want to or can be cutting edge. Social finance is only useful for social enterprises if it is accessible to them in the relatively small amounts they need at the time they need it and if it is relevant to their stakeholders. The social investment markets in most countries still need to see simple financial schemes and instruments rolled out so that they can cater for a large number of diverse organisations, and these should not all be in the traditional form of debt, which usually requires repayment long before a social enterprise is generating sufficient cash. But beware of making equity-like structures just too complex to manage.

Open a secondary market: Test and trial the development of a distinctive secondary market for social investments where early-stage investors would be able to sell on or share investments with investors that have similar social commitment and vision, but less appetite for risk.

Don't let political changes get in the way of learning: Within Europe, the UK probably has the greatest experience in social enterprise and impact investing policies. It is rich in its innovative thinking and development of financial instruments. Even after Brexit, it is expected that the UK will continue to have much to offer and to learn from what is happening in Europe. As we have seen elsewhere in this guide, strength comes from shared experiences and learning, as this reduces asymmetries in the information available to investors.

Remember that patience is a virtue: Molière wrote, 'trees that are slow to grow bear the best fruit'. Social enterprises can seem to be in a hurry, but the reality is that development can take time. As an investor, an intermediary or an enterprise, you may need to go through many iterations before you can move forward. Patience and stubbornness are essential virtues. Slow money that is in pace with such rhythms can be the perfect accompaniment for a growing social enterprise.

151 Alternative Commission on Social Investment (2015).

152 Social Investment Research Council (2015).

And finally...

Providing the right sort of money in the right amounts at the right time requires a much better understanding of both intermediaries and social organisations about the realities of running and funding the provision of social services to meet social need. Social entrepreneurs and practitioners need to get smarter at understanding what is required and negotiating with intermediaries for what they need, rather than trying to fit what they do to the money that happens to be available at the time.

This is the true meaning of capacity building in the context of social investment. It means equipping social organisations with the commercial acumen, knowledge of finance and language that they need to be able to access and negotiate sensible terms for the funding they require. It is about much more than the use of grant to provide temporary subsidies for loan costs or to pay for operating costs of intermediaries who themselves do not have a sustainable business model ⁽¹⁵³⁾.



Annex 1

About the pilot projects of the EU Preparatory Action

The European Commission launched a call for projects to develop, promote and disseminate new and more effective solutions to reducing barriers encountered in accessing social enterprise finance on both the demand and supply sides of the market. Following the two calls for proposals (in 2014 and 2016), a total of 21 pilot projects in 15 EU countries (shown below) were chosen for funding, which focused on the following strands.

Strand A (2014 and 2016): Establishment of social finance partnerships with the aim of addressing the supply aspect of social finance, notably in those EU countries where the market for social finance is not yet developed.

Strand B (2014 and 2016): Establishment of social finance instruments and mechanisms with the additional aim of tackling the supply side in countries where social finance is growing. It seeks to develop instruments that foster and formalise collaboration.

Strand C (2014): Establishment of collaborative funding models for social enterprises, with the aim of fostering market integration in EU countries where actors on the supply side of the social finance market are operating on an isolated, individual basis.

Strand C (2016): A variation of Strand C from 2014 is the facilitation of hybrid finance for social enterprises. It aims to facilitate the design, testing and establishment of suitable and needs-oriented hybrid financing models for social enterprises.

Strand D (2014 and 2016): Development of investment-readiness support for social enterprises, tackling the demand side of the social finance market with a view to strengthening the overall investment readiness of social finance.

Strand E (only 2016): Creation of a European-level platform to reinforce the capacity of social enterprise support organisations to address the insufficient capacity of such organisations and the lack of cooperation between them. This strand aims to bring together social enterprise support organisations with relevant experience and expertise, pooling their competence, resources and approaches in order to offer targeted support services for social enterprises and further develop tools, quality systems and knowledge.

The list of pilot projects financed by the European Commission during 2014-2015 can be found at: <http://ec.europa.eu/social/BlobServlet?docId=15501&langId=en> while those financed during 2016-2018 can be found here: <http://ec.europa.eu/social/BlobServlet?docId=16864&langId=en>.

Annex 2

Setting up a local social investment fund

In the early days of community investing, it was commonplace for public sector agencies to establish 'soft loan' funds to provide grants and low-interest loans to enterprises. These rarely focused on sustainability – let alone long-term outcomes – and were mostly loss-making. More recently, though, a number of other approaches have been developed to address the gaps in the provision of finance to SMEs, social enterprises and third sector organisations. Funds can also be set up at different geographical levels, and here we look at local funds. A local fund can offer linkages between local investors and local enterprises. This often feels more tangible and proximate and can reconnect resources and needs within a local economy. 'Think global: Act local' is more than a marketing truism. Establishing a local organisation enables tailor-made solutions to local problems, drawing upon informal intelligence and due diligence.

There are a variety of organisational models and objectives to consider in setting up a local fund. These vary from those seeking to be entirely independent and to generate revenue from their activities (including allowances for bad or doubtful debts) that will allow them to build a sustainable institution, to those who may prefer to add value to their fund through, say, the provision of training and enterprise development work, for which they anticipate receiving revenue support year-to-year. Some funds adopt voluntary staffing models; some are cooperatives with one member, one vote. Often, all borrowers are expected to become members of the fund and to contribute capital as well as take out loans.

Once you have established that there is a need and that a financial instrument is the right solution, there are nine steps to setting up a local fund.

Vision

You have a vision and an idea of need. ***Can you develop the idea and persuade others to share the vision?*** Getting everyone to collaborate is crucial for future success. Without a shared vision, each person will tend to view the organisation purely in terms of their own background rather than understanding the purpose of the fund. Clarity about who owns the fund, and in whose interest it is operating, will facilitate success.

Market research

Is a loan fund the right instrument for addressing the market? If the problem is personal debt rather than organisational growth, you may need a different approach. Ask yourself: ***Is there a sufficient market in the locality to support the fund?*** The concept of recycling funds within the community relies on the fund being there in the long term. Unless you are willing to make open-ended funding commitments, it must be able to sustain itself through its lending activities. Are there funders in addition to you? ***Are there additional sources at the regional, national or EU levels? Who are they? And can they be persuaded? Is anyone else serving the market? Who are the people and organisations whose support is necessary to the success of the venture?***

Development

There comes a point where the venture has to stop being a project and become an organisation in its own right, but it can take a long time to become a reality. *Is there a team in place with the right skills?* You'll need: sector knowledge; R&D ability; financial acumen; marketing and people skills; and, above all, the determination to bring it to fruition. A business plan needs to be developed. Based on your research, this will show you what you need to do to turn vision into reality and what the scale of your operation will be. Getting the board right is vital: they must share and lead the vision. If you have paid staff, you will also need to raise not just capital for the fund, but also revenue funding until you have a flow of sufficient loan income. Partners need to be identified and courted. Some may be funders, some may provide loan referrals, and some will add credibility. Each partner must understand the others' needs and come to an agreement on the partnership, otherwise misunderstandings about scope, responsibility and ability of each partner will damage the relationship. You may start within the existing management capacity of another agency. Moving into the choppy waters of the local community, where there may be political and social divides and conflicts of interest, will require careful and sensitive piloting.

Legal structure and building back office systems

The design of the legal structure is critical. The fund may not want to be regulated, but it will need to be able to raise capital. Before you become operational, ensure that your back office works and that it is more than enough to meet demand. Even banks rarely make money from this market, so you will need to focus on cost effectiveness and efficiency. Good software systems are available for back office operations, or you may wish to subcontract your back office services.

Raising capital

This is your lifeblood: without it, you will go nowhere. In the early days – maybe even years – every single euro lent has to be raised first. There are a number of ways to raise capital and these are addressed here separately. Although by its very nature capital is at risk, techniques have been developed to manage risk and create greater investor confidence. Potential investors should see that there is a competent, experienced team in place and a credible board to supervise this team. A guarantee fund could also be set up, capitalised by some funders who see the benefit of underwriting private funds.

Pilot lending

Start with some 'low-hanging fruit' (i.e. borrowers who are not in a hurry). It may take time to consider your first loan applications. Be clear about what you will fund and what you won't. It is up to you, but it is generally better not to allow appeals against declined proposals.

Marketing

Marketing is how you find people who really want what you have. Your board, staff and volunteers and you are the people who know how best to address a particular audience.

Becoming operational

Sooner or later, you have to make your vision a reality. With clear procedures, paperwork, technical systems, hardware, competent people and deals, everything is manageable. The detail is in processing transaction after transaction and getting it right every time. Expert advice will help you assess how you're doing.

Quality and review

You are going to hold money on trust. If a loan goes wrong, investors and borrowers may be worse off. Quality is vital at every level, and the people in the fund have to want to get it right – first time, every time ⁽¹⁵⁴⁾.

Action

The time to start is now!

Things to remember

- Always take appropriate legal and financial advice prior to setting up a fund.
- Lending can make people and enterprises worse off. Do not set people up to fail.
- Get too many visionaries together and you will have a university or a monastery. Progress requires unity of vision.
- To create any organisation, there has to be passion, perseverance and pig-headedness, probably in equal measure.
- As a fund, you must meet the highest standards of financial prudence and accountability, balanced against the risks of developing a new local market and meeting needs that existing providers are not serving.

Annex 3

Investors in Society: Charities Aid Foundation (CAF) takes an idea to pilot and scale

In 1992, in response to data showing that charitable giving was not growing quickly enough to meet the increasing demand upon the third sector, CAF commissioned research into whether a charitable bank could bridge the gap by lending to charities. This work was given added impetus both by the European Commission's White Paper on employment and competitiveness ⁽¹⁵⁵⁾ – which envisaged a significant role in employment creation for the social economy – and by the emergence of new forms of social enterprise that wished to avoid grant dependency. The research outcome was supportive, but the regulator – the Bank of England – was not. It told the promoters that they needed experience with an unregulated fund to test the idea.

The banks saw no market because in 1993-1994 there wasn't one. CAF had to establish the extent of latent and real appetite to borrow, and it had to establish where the funding would come from. Over the next 18 months, CAF covered many miles meeting people, facilitated a few loans for asset purchase or to bridge EU grants receivable, but it found little commercial bank appetite despite growing evidence of need.

Despite knockbacks on the way, Investors in Society was launched as a charitable fund within CAF with GBP 500 000 of CAF's money. The fund's remit was to meet unmet third sector need (including that of social enterprises) through financial instruments, predominantly loans and occasionally guarantees, wherever it considered it could manage the credit and operational risks. A fund structure was put in place that would stand it in good stead to accommodate growth and any future change in regulated status. Full due diligence would be carried out, with significant weighting given to management and governance quality as well as the societal consequence of not making the loan. Co-investors were sought among charitable foundations and donors. Over the next 5 years, the fund grew from GBP 0.5 million to GBP 5 million, some 200 enterprises received loans and several hundred more received training. No money was lost. Loans were priced arbitrarily at 6 % per annum, with secured loans marginally cheaper than unsecured loans. Pricing was structured on ability to pay rather than credit risk in the light of then higher prevailing rates. When interest rates fell, this left Investors in Society and follow-on funds comparatively expensive, but now access to finance was more important than price.

Initially, the demand side was slow to build. The market was new and untested and boards of both borrowers and potential investors were very conservative. As loans were repaid, as the communication message grew louder and as other funding sources began to contract, the pioneers could contemplate meeting growing demand by going to scale. There were few options other than becoming a bank. By 1995, the change in regulation from the Bank of England to the Financial Services Authority presented a window of opportunity. Very detailed business planning, risk modelling and policy drafting had to accompany an application to scale up to be a bank and a charity. Perseverance was an essential quality, as was the doggedness not to accept 'no' as the answer. In 2002, 10 years after the idea was first mooted, the authorities agreed to the establishment of Charity Bank as a successor to Investors in Society. Banking is an expensive business, and it took another 6 years for the bank to become profitable, during which time it used up some GBP 8 million of capital to meet operating and start-up costs as well as to meet ever-higher regulatory costs.

Throughout the 27 years from research to the banking operation today, the team challenged themselves as to whether they were meeting their mission and not distorting the financing of the sector. Some 1 000 Charity Bank borrowers were working with more than 3 million people, totalling 5 % of the UK population. Among values-based banks, Charity Bank has pioneered social impact measurement as a tool, not only to assist borrowers, but also to aid internal management processes and to help determine to what extent Charity Bank is an impactful lender ⁽¹⁵⁶⁾.



155 European Commission (1994).

156 Charity Bank (2017).

Annex 4

Designing an outcomes fund

Outcomes funds are financing vehicles that create frameworks in which payments only occur if pre-agreed societal outcomes are achieved. According to the not-for-profit organisation Social Finance, a key architect in the design of such funds, there is no unique, template model for such funds. The optimal structure will depend on various factors.

- **Market maturity:** The number of service delivery organisations capable of bidding into the fund and the level of prior knowledge about the cost of delivery and outcomes pricing.
- **Types of intervention that are funded and the outcomes sought:** *Is the fund seeking to build an evidence base for interventions by funding different solutions to the same challenge in parallel? Is the fund seeking to accelerate the scaling of evidence-based interventions in new contexts, such as new geographies or target populations? Or is it trying to test innovative and more complex delivery solutions through pilot projects?*
- **Level of flexibility:** The level of specificity around the focus and issue area being addressed and how much flexibility is considered valuable.

There are two broad categories of outcomes funds: **thematic and innovation.**

Thematic outcomes funds commission multiple interventions in parallel, by multiple providers, against an identical set of outcomes sought. The results are compared in order to build an understanding of what the most effective interventions are, and to determine the real cost of delivery and price per outcome achieved.

Innovation outcomes funds commission solutions that involve an element of co-creation between the funder and providers. This may involve bespoke delivery and one-off pricing and is well-suited to complex issues requiring tailored approaches. The solutions can be tested to learn about the effectiveness of a solution.

In practice, an outcomes fund will be tailored to a specific context and may sit somewhere between a pure thematic fund and a pure innovation fund. In its note on outcomes funds ⁽¹⁵⁷⁾, Social Finance provides a table comparing the two broad categories, assessing the circumstances that each is best suited to.

157 Social Finance (2018).

Annex 5

EU funding for social entrepreneurship: 2014-2020 and beyond¹⁵⁸

1. The European programme for Employment and Social Innovation (EaSI) 2014-2020

Through its **microfinance and social entrepreneurship** axis, EaSI provides support to financial intermediaries that offer microloans to entrepreneurs or finance to social enterprises. The aim is to address existing market failures and foster the development of the emerging social investment ecosystem through a comprehensive package of financial instruments and grants. Two instruments had been launched by 2018.

- The **EaSI guarantee:** a first-loss capped guarantee or counter-guarantee offered to selected financial intermediaries to cover loan portfolios in the areas of microfinance and social enterprises. Thanks to its risk-sharing mechanism, this financial instrument gives selected microcredit providers and social enterprise investors the opportunity to reach out to entrepreneurs they would not have been able to finance otherwise.
- The **EaSI capacity-building instrument:** aimed at building up the institutional capacity of selected financial intermediaries in Europe primarily through equity investments. Capacity-building investments can be used for several purposes, depending on the intermediaries' needs, for instance: investment in **branch expansion**; scaling up of **IT infrastructure** (e.g. mobile banking); investment in **human resources**, such as the recruitment and training of staff; and operating expenses aiming at contributing to **sustainability**.

The European Commission has selected the European Investment Fund (EIF) to implement the EaSI guarantee and capacity-building instruments.

2. European Fund for Strategic Investments (EFSI)— social impact investment instruments

The EFSI represents the core of the European Commission's investment plan for Europe ⁽¹⁵⁹⁾. The European Commission and the European Investment Bank (EIB) Group launched the EFSI to help overcome investment gaps in the EU by mobilising private financing for strategic investments.

The aim of the **EFSI Equity social impact investment instruments** is to enable the piloting of a number of innovative instruments in support of social enterprises and social innovation.

158 Additional information can be found in the European funding toolkit developed by the Euclid Network, which is available at: euclidnetwork.eu/templates-toolkit

159 European Commission (n.d.b).

Three social impact investment instruments targeting financial intermediaries are brought together under the EFSI Equity instrument:

- investments in or alongside financial intermediaries linked to incubators, accelerators and/or that provide incubation services;
- investments alongside business angels or investments in business angel funds;
- Payment by Results or SIB investment scheme.

These three instruments are mutually complementary and cover a large spectrum in terms of the financial intermediaries, final recipients and market segments targeted.

Table 11. Summary key terms of investments under EFSI Equity social impact investment instruments
Source: European Investment Fund (n.d.a)

	Investment in or alongside financial intermediaries linked to incubators/ accelerators	Investment alongside business angels or in business angel fund	Payment by results
Type of investment scheme	Investment or co-investment scheme	Investment or co-investment scheme	Investment or co-investment scheme
Type of counterpart	Typically venture capital funds linked to incubators, accelerators and/or that provide incubation services to social enterprises	Typically business angels or business angel funds targeting social enterprises	Typically investors in Payment by Results schemes (NPIs, payment by results manager or arranger, etc.)
Type of underlying products	Long-term risk capital investments in the form of equity, preferred equity, hybrid debt equity instruments, other types of mezzanine financing	Long-term risk capital investments in the form of equity, preferred equity, hybrid debt equity instruments, other types of mezzanine financing	Long-term risk capital investments in the form of equity, preferred equity, hybrid debt equity instruments, other types of mezzanine financing
Type of target beneficiaries	Primarily social enterprises established or operating within the EU, ranging from pre-commercial stage up to early growth stage	Primarily social enterprises established or operating within the EU, ranging from seed stage up to expansion stage	Social enterprises and social sector organisations established or operating within the EU

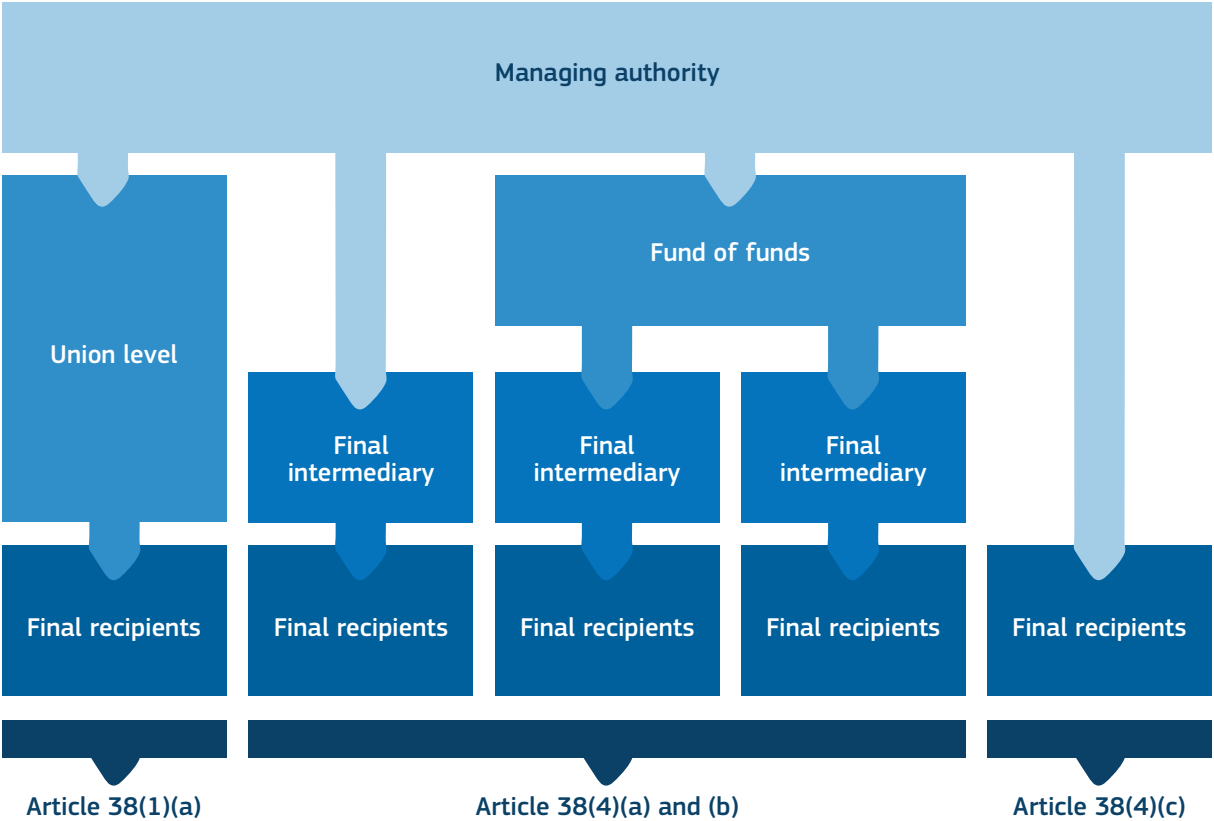
3. European Social Fund (ESF) 2014-2020

Social enterprises can also play an active role in addressing the goals of the **ESF**. In particular, thematic objective nine in the ESF Regulation (EU) No 1304/2013 – promoting social inclusion and combating poverty – for the 2014-2020 programming period includes an investment priority specifically designed for social enterprises: ‘promoting social entrepreneurship and vocational integration in social enterprises and the social and solidarity economy in order to facilitate access to employment’.

Most of the budget allocations under the European Social Fund are implemented by Member States via managing authorities and take the form of grants. However, financial instruments are also a possibility.

There are different options for implementation arrangements according to Article 38 of Regulation 1303/2013 (Common Provisions Regulation), each of which involves roles and responsibilities being assigned to different bodies. The structures, as shown in Figure 21, vary from financial instruments set up at EU level, managed directly or indirectly by the European Commission, to financial instruments set up at national, regional, transnational or cross-border level, such as the managing authority, any fund of funds and financial intermediaries interacting together.

Figure 21. Structure of financial instruments for the ESF
Source: FI Compass (2019)



The managing authority may:

- contribute resources to EU-level financial instruments (such as the EaSI guarantee or EaSI capacity-building instrument);
- invest in the capital of an existing or a newly created legal entity;
- entrust implementation tasks to another entity;
- undertake implementation tasks directly (for loans and guarantees only).

Depending on the implementation structure, the managing authority may decide to implement the financial instrument through a financial intermediary or in two stages through a fund of funds.

4. Post 2020 – A new framework for EU financial instruments 2021-2027

As part of the next multiannual financial framework of the EU, which covers the period 2021-2027, the European Commission has proposed a single investment fund, the ‘InvestEU Fund’. The proposal foresees a dedicated EUR 4 billion ‘social investment and skills window’ to mobilise public and private investment in support of social investments, including for microfinance and social enterprises.

As a complement to InvestEU, the European Commission proposed to further strengthen the Union’s social dimension with a new and improved ESF, the European Social Fund Plus (ESF+) which has a budget of more than EUR 100 billion. Together, InvestEU and the ESF+ open up new possibilities for building up the social investment market ecosystem ⁽¹⁶⁰⁾.

InvestEU is designed to pursue efforts made under the financial instruments of the EaSI programme. It aims to bridge financing gaps through the provision of a complementary toolbox of financial products tailored for microfinance and social enterprise and social innovation finance, as well as to support new systematic developments in the emerging social investment ecosystem. In January 2019, the European Parliament adopted the InvestEU draft regulation, including the provision that 40% of all financing and 65% of financing in the area of sustainable infrastructure for climate protection. All funded projects will have to comply with environmental guidelines.

The ESF+ will continue to tackle unemployment, poverty and exclusion. It will also remain the main EU instrument investing in policy and systems reforms with the aim of enhancing peoples’ skills and level of education.

160 At the time of writing, the European Commission proposals for InvestEU and ESF+ were under discussion in the European Parliament and Council.

Annex 6

Crowdfunding: Regulation, pitfalls and opportunities

As explained in Section 3.3., crowdfunding is a growing component of the online alternative finance market. It primarily uses internet platforms to seek finance directly from individuals, corporations and institutions, and may be donation-based, reward-based, equity-based or take the form of peer-to-peer lending. While crowdfunding can be an effective and promising way to invest socially, this annex explains the relevant regulation and pitfalls, as well as some opportunities, which relate to this form of finance.

Since 2013, the European Crowdfunding Network (ECN) ⁽¹⁶¹⁾ has aimed, among other objectives, to deliver self-regulation across the European crowdfunding industry. Regulation is currently uneven across Europe, and many EU countries either have no dedicated regulation or apply rules not designed to cover this type of activity. The market in the UK, for example, is split: lending and equity crowdfunding are regulated by the financial regulator, while donation and (non-financial) reward crowdfunding are self-regulated. In November 2015, the European Commission published its mapping study to analyse market trends and the impact of national legislations on crowdfunding ⁽¹⁶²⁾. According to the report, there were 510 crowdfunding platforms in Europe, but less than 40 % had useful data. A further report on the current state of crowdfunding in Europe, 2016 ⁽¹⁶³⁾, found that donation-based crowdfunding is possible in every European country under existing regulations although in some, including Finland, additional conditions such as a strict Act on Fundraising applies.

Reward-based crowdfunding is also possible under existing regulations, although in some countries it is regarded as e-commerce with refund obligations. The VAT regime is also not harmonised. Regulations regarding peer-to-peer lending differ from country to country; indeed in some countries, such as Belgium, peer-to-peer lending is prohibited, while in France an entrepreneur cannot lend to another entrepreneur. In most countries, equity-based crowdfunding is possible under existing regulations for securities intermediation but is subject to very strict rules. In Denmark, for example, equity-based crowdfunding is not possible for Danish domiciled businesses. A way round this is to open a pro forma address in a foreign country where a crowdfunding platform exists, which is one of the reasons for the proliferation of cross-border platforms. Many successful platforms have a presence in neighbouring countries.

From the first round of EU pilot projects, at least two organisations – iPropeller and Social Impact Hub – have included a crowdfunding platform in their ambitions. In 2015, another pilot project run by Oksigen Lab launched Oksigen Crowd to connect people with innovative social enterprises. The learnings from that have now led to the launch of crowdfunding platform, Gingo ⁽¹⁶⁴⁾, together with Bank Degroof Petercam. Gingo is a donation-based crowdfunding platform. It focuses on existing innovative initiatives with high social impact. A growing number of social banks have also launched crowdfunding initiatives to extend the engagement of savers with smaller social enterprise needs. A number of social banks now provide access to crowdfunding platforms to enable their savers to support smaller enterprises. Some social stock exchanges also use crowdfunding platforms to offer listed social business investments to retail investors (see more in Section 4.2.).

161 European Crowdfunding Network (2019).
162 The Social Investment Intelligence Network (2018).
163 Crowdfunding Hub (2016).
164 Gingo (2019).

Crowdfunding also provides a challenge to traditional banking mindsets where the funding often seemed to have priority over the aims and/or philosophy of the business. In the ‘crowd’, it is the business idea that triggers the flow of funding. Fintech is enabling change even in this relatively new field.

EXAMPLE: CROWDFUNDING INITIATIVE SEEDBLOOM

Seedbloom is an Estonian foundation building a seeding, equity crowdfunding and governance platform for cooperatives and ethically driven enterprises. It claims ⁽¹⁶⁵⁾ that it will combine progressive cryptographic technologies including IPFS ⁽¹⁶⁶⁾, smart contracts and immutable ledgers, as a result of the work of a team of legal experts and coders. Seedbloom is seeking to build a mutually supportive ecosystem of projects that harness the strength of their collective networks to support each other’s growth.

The Seedbloom 6Fund also seeks to provide supplemental capital to support the growth of enterprises after their initial crowd equity campaign. As a result, enterprises know that when they raise capital through Seedbloom, they are also supporting projects that have come before and are contributing to a pool of capital that projects (including theirs) can call upon in the future.

A few pitfalls to watch out for

- Where regulation is in place, the regulator is keen to ensure that you (the investor) have the financial means to invest, that you have taken appropriate advice and will only invest less than 10 % of your investible assets (UK). Although the rules were relaxed for US investors worldwide in 2016, the investable sums per person remain modest. In mid 2018, the UK financial regulator (the Financial Conduct Authority) proposed tougher rules for peer-to-peer lending to bring the largely loans-based sector in line with existing tougher regulation for investment-based crowdfunders.
- Crowdfunding platforms do fail, often through fraud or overambition ⁽¹⁶⁷⁾. The platform is required to have formal back-up in place so that if the platform goes down for any reason, the portfolio and the funds are picked up by the back-up platform. When you carry out your due diligence on a platform, you should check whether the platform hosts an investor or is simply a broker who places the investment with other institutions.
- You may be used to carrying out detailed research and due diligence on potential investments. The information you will get about an enterprise is very limited and may be no more than a three-minute video. You may be investing ‘blind’ compared with the normal due diligence you would perform. The enterprises are rarely warranted or underwritten by the platform or the sponsor (if the platform is hosted) and in the case of loans, they are generally unsecured. This could be considered more alarming in the light of Nesta research that shows that 66 % of equity crowdfund investors regard themselves as retail investors with no previous experience or knowledge ⁽¹⁶⁸⁾.

165 Seedbloom (2019).
166 IPFS (interplanetary file system) is a peer-to-peer hypermedia control that aims to make the web faster, safer and more open. Source: IPFS (2019).
167 See Carpenter (2017).
168 Nesta (2012).

- Investments can be illiquid and you should expect to hold them to maturity. Platforms often compare what you can earn from investing to returns on savings accounts, but the illiquidity issue (where a security or other asset cannot easily be sold or exchanged for cash without a substantial loss in value) makes such comparisons misleading. Lack of liquidity can be addressed by developing secondary markets. In 2017, the first secondary markets began to emerge. StartEngine in the US was first and was followed by Seedrs, the UK’s second-largest crowdfunding company based on shares bought on its website ⁽¹⁶⁹⁾. There is a specific pain point for crowdfunding platforms: investing in early-stage companies requires patience as most gains, if any, can take considerable time. Because investors cannot trade shares in the way a regular market does, some investors prefer to exit following a crowdfunding round rather than face dilution and the prospect of illiquidity.
- The crowd often invests alongside venture capitalists in equity issues but may then find that their equity dilution means they do not share in the upside anywhere near as much as the institutional investors do.



A few questions to ask yourself if you are an intermediary intending to create a platform:

- Will you try to build the platform yourself or outsource it? Have you tested it for anti-money-laundering issues? And who will take it on when/if your platform goes down? Will you keep investments as principal or simply broker them to someone else, such as an institutional investor?*
- How will you handle any potential conflicts of interest with other services you may offer, for example investment-readiness support or due diligence?*
- How will you build the platform’s visibility and ensure enough deal flow to guarantee your own viability?*
- How will you manage deal or enterprise failures?*

169 While still small, the secondary market has had 1 330 share lots traded (early 2018).

A few suggestions to take on board

- Know your sector. Avoid the noise of the crowd and stick to things you know something about. Different platforms deal with different types of companies and different growth stages.
- Diversify much more than you normally would, if you are an investor. You can have lots of investments between EUR 50 and EUR 500.
- Look to the experts. Let the smart people do the due diligence and then ride on their coat-tails. Some platforms will tell you who else is investing in a start-up. As with other forms of investment, ask yourself: *Do you trust these people?*
- Look for the social. Most platforms and investors are looking for high financial returns. Only a few, for example Abundance (UK) offers ‘investments that build a better world’. Another example is StartSomeGood, which offers ‘a different kind of crowdfunding platform, for a different kind of crowd’. Nesta has published a list of crowdfunding platforms for (predominantly UK-based) social entrepreneurs. At least one, Crowdfunder, operates globally and claims to have helped start-ups raise over GBP 55 million for projects tackling some of society’s most important challenges ⁽¹⁷⁰⁾. Other lists come from Forbes and Lincoln Martin ⁽¹⁷¹⁾.

Done well, crowdfunding can make social finance more democratic, with much wider reach. Remember, too, that the crowd is not just a source of financial support. **Crowdsourcing** can help you to develop your supply chain with individuals or organisations who may have similar values to yours. It may be finance, but it is just as likely to be ideas, project input or products and services ⁽¹⁷²⁾.



170 Crowdfunder (2019).

171 For a list of crowdfunding sites for social enterprises and NGOs, see Lincoln Martin (2019); eight crowdfunding sites for social entrepreneurs can be found at Forbes (2019)

172 For more information on crowdsourcing, see Investor Training Academy (n.d.).

Glossary of financial instruments

There are a number of financial instruments designed to address the funding needs of social enterprises including gifts, money that is repayable (informal and formal), and money that should be regarded as permanent (unless the investment is sold to another investor or a trade buyer, or can be redeemed from surpluses). Guarantees are a contingent liability that only become one of these instruments when the organisation is called to pay. The generic types of instruments are listed in Section 3.5.1, together with their implications for the enterprise receiving the money and the social investor providing the money. By their nature, hybrid instruments – including mezzanine capital – are a mixture of the generic categories.

Within these categories is a plethora of instruments, as summarised below. Where possible, we have added our (subjective) ranking of their feasibility and relevance to catalysing social investment. We also look to the future and possible instruments that may emerge.

1. Grants and gifts

1.1. Grants or gifts

Grants and gifts are the classical tools of grantmakers, foundations, corporations and individuals (donors). These instruments can be unrestricted, meaning that the recipient can use the money where it sees fit, or they can be restricted. We would see unrestricted grants or gifts as falling outside social investment because they are not repayable, although they may form part of a layered or hybrid financing structure and are a key ingredient of social finance overall. The word ‘restricted’ in this context means the money must be used solely for the purpose and on the terms agreed upon. If the enterprise does not comply with these terms, you may be able to claw back the money. However, it may have already been spent, so there may be nothing to claw back except the enterprise’s reputation. Public authorities and lotteries can impose clawback conditions on larger grants (typically those above EUR 150 000). This can make it difficult for an investor to take security which ranks equally with, or ahead of, the grantmaker.

The amount of documentation will vary from donor to donor and with the nature of the grant. The grant can be taken straight to income, but may need to be shown as a contingent liability if subject to clawback.

Relevance: (HIGH) They are particularly relevant for social enterprise start-ups, innovators and those with charitable status.

Feasibility: (HIGH) They work, provide the largest amount of social finance and have leverage capability in terms of investment. They are also a key ingredient in integrated capital.

1.2. Recoverable grants

A recoverable grant is a less common form of grant and, in legal terms, is arguably a loan rather than a grant. The terms under which the grant can be recovered are agreed upon in advance by the social investor and the recipient, which can be an intermediary as well as a front-line enterprise. Recoverable grants are designed to focus the recipient on sustainability and a reduced risk of grant dependence. Because the grant is recoverable and therefore capable of being returned to the investor, it may not attract beneficial tax treatment in the hands of the provider.

Documentation can be complex. It has to be shown as a liability in the recipient’s accounts.

Relevance: (MEDIUM) They can help the recipient manage initially higher risks before moving to income generation, and can reinforce mission focus if the donor and recipient are on same page.

Feasibility: (MEDIUM) They are not widely used and require regular monitoring by a donor.

1.3. Venture philanthropy

Venture philanthropy covers the impact-only and impact-first sections of the spectrum. The venture philanthropy approach includes the use of the entire spectrum of financing instruments (grants, equity, debt, etc.) and pays attention to the ultimate objective of achieving societal impact. Since this is at the heart of the investment, venture philanthropy funders place emphasis on impact measurement and its inclusion in the investment process.

Relevance: (HIGH) Venture philanthropy can be an essential resource of financial and non-financial support for early-stage enterprises. The model is intensive, so one-to-one support has limited availability, and there is little link-up with later-stage finance.

Feasibility: (MEDIUM) The spread within Europe has slowed and most European foundations have limited resources.

1.4. Immediate public opportunity

A novel non-profit variation on the IPO where charitable donations are recast as ‘shares’. Californian non-profit Homeward Bound has used this model twice to raise USD 1 million on each occasion for housing for families moving out of homelessness. For each USD 50 share purchased (i.e. donation made), each shareholder receives a share certificate and an annual report detailing how the money is used and the impact of the dollars spent on the community. There is also an Annual Shareholder Meeting. The first immediate public opportunity share issued by Homeward Bound was bought by Warren Buffet, one of the world’s most prominent philanthropists.

2. Repayable finance

2.1. Family and friends

Most entrepreneurs have circles of friends and family or other supporters who may be willing to provide resources – financial or otherwise – at the blueprint stage of an initiative. Amounts will generally be small and provided on a variety of terms. This kind of funding is very useful in demonstrating that an enterprise has support and that it has been able to test its thinking with others who can provide challenge and agree the risk parameters.

Documentation varies but may be no more than a handshake.

Relevance: (HIGH) This is particularly relevant for start-ups or for developing innovative ideas.

Feasibility: (MEDIUM) Not all social entrepreneurs want to have a moral obligation to friends or family.

2.2. Trust loans

With trust loans, you lend to a social entrepreneur you know. You agree what the money will be used for and shake hands. You trust the person to repay you on the agreed date or when an agreed event occurs. If they don't repay, they suffer reputational damage, and this can impact the ability of their peers to raise similar finance. Trust loans are an extension of family and friends finance and are common in Islamic finance but also, arguably, the way lending used to be done.

Documentation usually involves nothing in writing, but could be a simple 'IOU' or loan note. Unsecured.

Relevance: (MEDIUM) Trust loans have a role to play, especially for social enterprises investing in each other. However, there is limited awareness of this type of financing.

Feasibility: (LOW) They are most relevant in Muslim communities or small, tight-knit ones. Trust loans are usually held to maturity, as the 'contract' is personal rather than at arm's length.

2.3. Programme-related investments (PRIs)

Unlike grants, PRIs take the form of low-cost loans, loan guarantees, linked deposits and, less frequently, equity. They were created in 1969 by changes in the US federal tax system to encourage foundations to spend down part of their corpus. PRIs are now provided by foundations worldwide. Although the sums are relatively large (several billions of euros), the number of foundations providing PRIs is relatively small. They extend the reach of a donor's programmes by being able to make larger commitments in the expectation of capital return, together with below-market, risk-adjusted rates of interest (usually 1-4 % per annum) and for periods from a few months to more than 15 years. PRIs have been used extensively in community development and affordable housing. They can be used by the recipient to build a debt service track record and financial management skills before moving on to another lender. PRIs can also be used in a mixed funding package.

There is no set PRI structure, so documentation can vary. Some are secured against recipient assets, including future income. The Ford Foundation decided to make all PRIs unsecured to reduce documentation and put trust back at the heart of the transaction (see **Trust loans**).

Relevance: (HIGH) Finance is usually available at lower costs and on more flexible terms. They can be mixed with grants and more commercial finance.

Feasibility: (MEDIUM) PRIs are working in some markets, but they are not universal. They require more legislative encouragement in Europe.

2.3.1. Linked deposits

An investor has funds but may not be able to commit them for the term that the enterprise or intermediary is ideally looking for. The investor places funds on deposit with the enterprise's bank and 'donates' the interest earned to reduce the interest charge to the borrower. The investor is not guaranteeing the loan, and usually the deposit cannot be offset against the loan if there is a default. In the early days of development trusts in the UK, more

established, endowed trusts deposited money with the bank NatWest on which they forwent interest so that newer trusts could borrow from the bank.

Relevance: (MEDIUM) They can be useful in building a financial track record for a young enterprise, but have had limited application.

Feasibility: (MEDIUM) Linked deposits have worked, but may not be as useful as they should be because the lender still needs to take a view on the enterprise's credit risk. The investor could lose money if the lender fails or there is a spike in inflation that means the investor foregoes a financial return.

2.3.2. Shared growth deposits

Canada's largest credit union, Vancity, has a shared growth deposit programme in which savers buy RRSP-eligible ⁽¹⁷³⁾ term deposits at a guaranteed competitive rate, which are then invested in initiatives with a high social or environmental value, including its peer lending programme. A few North American foundations buy these deposits as part of their PRI programme.

Documentation is required between the investor and the bank and between the investor and the borrower, but formality can vary. It is not a formal tripartite agreement.

Relevance: (MEDIUM) They can be helpful in kick-starting a banking relationship, especially for younger enterprises. As with the 90/10 funds in France, they route long-term retirement savings into defined social enterprises. Their downside is the restrictive definition, which excludes many innovative enterprises.

Feasibility: (MEDIUM) This type of funding works, but it needs greater investor awareness and managing as investor liquidity changes.

2.4. Working capital loans

Short-term (typically 3-18 months), preferably unsecured, flexible loans to cover the range of working capital requirements. The enterprise will need a repayment plan and cash flow to show how and when the loan will be repaid. An investor will probably want to see possible repayment from more than one source to reduce their risk. Many commercial lenders seek a floating charge over the enterprise's assets so that they can force the enterprise to sell something to repay them if cash flow is not enough. Floating charges can restrict the enterprise's ability to raise debt elsewhere or for other purposes without the original lender's approval.

It should also not be overlooked that some social enterprises are also (reluctant) short-term lenders to their customers. Past-due trade debt is a significant issue, especially with governmental or other public purchasers. In the commercial sector, unwilling lenders charge punitive fees on past-due trade debt and remove prompt payment discounts. Social enterprises often feel they do not have the clout to take such action.

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A registered retirement savings plan, or RRSP, is a tax-privileged savings account. See also Annex 5.

Documentation can be as simple as a loan note supported by a cash flow forecast signed by both parties, or as complex as security requires.

Relevance: (HIGH) Working capital loans are very useful for enterprises that are asset poor or services-oriented, or for intermediaries that are not prepared to offer security because it will affect other relationships.

Feasibility: (MEDIUM) As most social investors do not provide for the full range of an enterprise's needs and therefore cannot see all the money flowing in and out, many are reluctant to provide working capital without security. This aspect can undermine the usefulness of these loans. Working capital loans are short-term by nature, so do not lend themselves to refinancing except as part of a larger portfolio.

2.5. Receivables discounting

A form of working capital finance where the investor 'buys' a defined stream of future income from the social enterprise, say, the proceeds of a government contract. There are several ways this can be done. **Without recourse discounting** means the investor takes the payment risk of the purchaser and the enterprise's performance risk. Depending on how much weight they attach to those risks and how long the money is needed for, the investor will offer the enterprise X % (X centimes in EUR 1), often 60-80 % (so, a 20-40 % discount) of the face value of the money you are due to receive. **With recourse discounting** means that if the purchaser does not pay in full for whatever reason, the investor still has recourse to the enterprise for the balance plus interest. In this case, the discount should be lower.

Documentation will vary, reflecting the nature of the facility. If it is without recourse to the enterprise, the facility comes off the enterprise's balance sheet and appears on the lender's until payment is received. If it is with recourse, the borrower must keep the amount on its balance sheet until payment is received.

Factoring is a form of receivables discounting provided by specialist investors in the SME market, where it is widely used and where the specialist investors take over the whole payment process.

Documentation is often standardised and can be used for block discounting where, for example, all contracts of a certain type with one purchaser are discounted on the same terms as they arise.

Relevance: (HIGH) Many social enterprises are asset poor and earn revenue from contracts that can be discounted to provide immediate cash for the enterprise.

Feasibility: (LOW) Many social enterprise customers are public agencies operating within politically determined budgets or policy priorities that can be changed at short notice. The nascent state of this market means there is no actuarially evidenced payment history to allow discounters to price risk (which is essentially political) with any confidence. There may be room for specialist investors to provide discounting or factoring, especially using internet platform technology. There is no secondary market in social enterprise receivables, unlike in the mainstream market where the secondary market is significant.

2.6. Microcredit

These are small, very short-term loans; they usually last only for weeks or a few months and are often for a value of less than EUR 1 000 equivalent. The average size varies from region to region and would be higher, though less

than EUR 10 000, say, in Europe. They are generally made on an unsecured basis to individuals, including social entrepreneurs, rather than to enterprises. At EU level, the microloan is defined as a loan of less than EUR 25 000.

Microfinance forms part of a number of social investors' portfolios and is now seen as an established market with significant datasets. The type of microfinance an investor will engage in will reflect their appetite for risk and regions of interest. Investors need to be confident that repayment rates do not mask high levels of refinancing.

Documentation varies from provider to provider. Some are social lenders, seeking to reach the poorest they can on affordable terms, while others seek to maximise financial return for investors.

Relevance: (MEDIUM) Microcredit is still relevant to social entrepreneurs in deprived communities and some Eastern European countries, but need may be greater than is provided by these funds.

Feasibility: (MEDIUM) There is a mismatch with demand, but some of the concepts of microfinance, such as peer group lending and measurement, can be adapted.

2.7. Medium-term loans

After grants, medium-term loans are currently the largest component of social investment. They are provided by a range of investors, including institutions and individuals, but predominantly by values-based banks. Loans come in all shapes and sizes and are the dominant instrument by default. Indeed, several social enterprises cannot absorb equity for structural reasons or because external capital is anathema to them. Some examples are provided below.

Typically, a medium-term loan would be from 3 to 7 years, but can even be 10 years. It may be used to refurbish existing assets, invest in intangible assets (such as software or new skills) or invest in new ways of service delivery, all of which will take time to be reflected in the income statement.

The loan may be **secured** against the asset to be financed or against all the assets of the enterprise, or it may be **unsecured**, meaning that if the initiative being financed does not generate sufficient income and there is not enough income from other sources, the investor will lose all or some of their money. Many social enterprises have very few assets capable of realising enough to repay an investor, so the concept of security becomes one of being able to remind the borrower to be watchful and, in exceptional circumstances, to enable the investor to have a seat at the table and encourage a change of direction or even of management.

Documentation will vary to reflect not only the nature of the loan but also the nature of the relationship between investor and borrower. The Ford Foundation, for example, wanted to make loans to borrowers it had previously worked with as grantees. As mentioned (see PRIs), to take that trust forward, these loans were unsecured and documentation was consequently short. Secured loan documents, on the other hand, can be many pages long and written in legal language.

Relevance: (HIGH) Medium-term loans are very relevant to social enterprises, especially in the absence of other instruments.

Feasibility: (HIGH) They are a relatively straightforward way for social investors to make investments. As yet, there is little secondary market activity, not only because of the lack of intermediaries, but also because the enterprise seeks a long-term relationship, as do the values-based banks who predominate.

2.8. Long-term loans and mortgages

Long-term loans can last for periods of up to 25 years, but because some social enterprises engage in long-term infrastructural development, the term can extend to 50 years (or at least the economic life of the asset being financed). Almost invariably, these loans are secured against the asset and probably all the assets and cash flow of the borrower. They are used to finance building purchase, construction and adaptation, as well as plant and equipment. They also provide finance for the development of affordable housing and the provision of utilities, such as water and energy, and of transport services. The term mortgage, which comes from the old French meaning ‘death pledge’, refers to the legal pledge of the asset to the investor ‘dying’ when either the loan is repaid, or the property is taken by the investor through foreclosure. Mortgages enable social enterprises to undertake long-term initiatives that would otherwise generate insufficient revenue in the short term to effect repayment.

The Chantier de l’économie sociale Trust is a good example. It offers patient capital for operations or real estate development with a 15-year moratorium on repayment of principal. Investments range from CAD 50 000 to CAD 1.5 million, not exceeding 35 % of a project’s costs, and the interest rate is fixed at the time of approval. Fees include 3 % of the investment to mitigate risk and a 1 % annual management fee payable with each monthly interest payment. Because of the moratorium on principal repayment, the Trust’s patient capital can be used to leverage more financing. Funds are available for a number of purposes: start-up or expansion, the development of the enterprise and the adaptation of its products and services or the acquisition, construction or renovation of real estate (land or buildings). Real estate patient capital is secured by a real estate mortgage subordinate to real estate mortgages that may be held with other lenders.

The Trust is rooted in Quebec’s social economy, working with local enterprises and development agencies to identify enterprises requiring long-term capital, reducing the risks to investors and increasing the capacity of enterprises through capacity-building support and access to markets. An annual province-wide survey of potential investees is the first step in identifying investment opportunities. The Trust has invested CAD 56 million in 219 collective enterprises throughout Quebec, creating/preserving 3 307 jobs and generating CAD 402 million of investment ⁽¹⁷⁴⁾.

Documentation relating to long-term loans and mortgages can be complex and lengthy. The investor’s rights over the secured asset(s) take priority over the borrower’s other creditors. The extent to which these other investors are repaid will be determined by the sale proceeds from the asset. The loan can take many forms, from loan notes to bond issues.

Relevance: (HIGH) They are relevant to larger social enterprises with skilled management and systems to manage the loan or bond. Because they will carry interest payable on a regular basis, they can be expensive in real terms over 25 years.

Feasibility: (HIGH) There is an existing market, but new social investors may be cautious to join. The size of the loans needed often encourages co-investment and the layering of a transaction to allow investors with different risk appetites to participate. As with other models, there is little secondary market activity at present, so liquidity is scarce. Investors should expect to hold their loan for the term of the deal.

2.9. Bonds

Bonds are a form of debt. A bond is the promise to repay the principal along with interest, often evidenced by coupons. They are usually issued for defined periods of more than 1 year and can be a fixed or variable rate. In the commercial sector, bonds can be quoted on exchanges and the price changes to reflect the presumed creditworthiness of the borrower and the yield as the bond approaches its redemption date. Bonds were particularly popular in the 19th and early 20th centuries, when Victorian philanthropists often sought a 5 % return on their investments in model urban housing and settlements. In recent times, bonds have reappeared as a way of financing third sector initiatives, including social enterprises. The classical mainstream market meets the very largest needs, such as the Wellcome Trust’s EUR 400 million 2027 bonds (with very low interest rates, the bond issue was oversubscribed 7.5 times) or bonds issued by social housing landlords or universities.

In the US, a few community development financial institutions have investment-grade Standard & Poor credit ratings. In 2017, The Reinvestment Fund issued USD 50 million in bonds while Local Initiatives Support Corporation (LISC) issued USD 100 million. Investors in both bonds included insurance companies. There are no constraints on how the bond proceeds are used. The Reinvestment Fund’s bonds have 6-, 7- and 8-year maturities while LISC’s are spread over 10 and 20 years.

Relevance (MEDIUM): As with mortgages, bonds are relevant to larger social enterprises with skilled management and systems to manage the bond. In unstable financial conditions, they can be an attractive way to raise fixed cost money and enable an enterprise to manage its interest rate exposure. However, there can be expensive early redemption fees.

Feasibility (MEDIUM): There is an established market, although not throughout Europe. In the UK, bonds are provided by some of the mainstream banks and specialist intermediaries.

2.9.1. Retail charity bonds

The Retail Charity Bonds platform in the UK, created by Allia, allows established charities with strong credit ratings to borrow between the equivalent of EUR 10 million and 50 million over 5 to 10 years, although many of the early issues have been for smaller sums. Despite the name, charity bonds are also available to established social enterprises. In the aftermath of the financial crisis, when bank credit dried up, bonds allowed charities and social enterprises to diversify their sources of investment capital and increase their resilience to supply-side shocks.

Successful bond issues require a degree of sophistication amongst service providers in the market. One possible reason for the development of charity bonds in the UK was the simultaneous launch of the Investment and Contract Readiness Fund (ICRF), which provided support to reduce the cost of retaining advisors to navigate the process (a role since assumed by the Access Fund), as well as the emergence of specialist capital advisory firms and a fund to underwrite part of the issue while investor demand develops.

Relevance (MEDIUM): Charity bonds are a relatively new market, but attractive to a growing number of social enterprises as they appeal to individual social investors and so tap into new sources of finance. They are often unsecured, with fewer covenants, more flexible terms and longer durations than bank debt.

174 Fiducie de Chantier de l’économie sociale (n.d.).

Feasibility (LOW): Although they are relevant to a wide number of social enterprises, many European markets do not yet have a sufficiently developed social finance ecosystem to sustain a market in charity bonds or provide secondary market liquidity.

2.9.2. Community bonds

Community bonds enable individuals, as well as social enterprises themselves, to invest in tackling a whole range of social issues, pooling their financial resources for the mutual benefit of that community.

The Scottish Community Reinvestment Trust, for example, has launched pilot community bonds. Investments from GBP 50 to GBP 5 000 are pooled within an overall limit of GBP 100 000 (GBP 40 000 subscribed) for on-lending only to enterprises who are members of Scotland’s Social Enterprise Networks and who comply with the ‘social enterprise code of practice’ ⁽¹⁷⁵⁾. The bonds expect to accrue 2 % gross interest yearly from 2018, with the first payments being made in 2021. The investment period is 3-7 years. The value of the bonds cannot increase beyond their nominal value but can fall.

In Canada, the Centre for Social Innovation ⁽¹⁷⁶⁾ was able to raise CAD 6.5 million (approximately EUR 4.29 million) to purchase real estate by issuing a 5-year, 4 % mortgage-backed community bond. Investors must purchase a minimum investment of CAD 10 000 (approximately EUR 6 600). These bonds are eligible for tax savings accrued to investment in the public retirement system in Canada (RRSP).

Relevance (HIGH): The ability to issue or invest in small-scale bonds can be very attractive to both borrowers and investors, whilst also providing a low-cost entry point for new players. As in the Scottish example, they can be developed by intermediaries.

Feasibility (MEDIUM): Community bonds are an emerging instrument that intermediaries can use to reach sub-market-sized demand. They are likely to appeal to small or young enterprises.

2.9.3. Vaccine bonds/green bonds

Vaccine bonds raise upfront capital to finance vaccination programmes against long-term donor government pledges on an international scale. Using debt capital markets to fund climate or positive environmental benefits, **green bonds** are earmarked for green projects. Some have recourse solely to the project being financed, but many are backed by the whole institution. For example, the EIB Climate Awareness Bond is backed by the EIB itself. They are priced in the same way as other bonds from the same issuer, but they have a positive environmental outcome. Climate bonds are green bonds focused on tackling climate change and are the ‘visible part of the iceberg’.

It is too early to judge how important they will be in the financial ecosystem.

2.9.4. Social impact bonds (SIBs)

Although SIBs are also bonds, they are more complex. In times of austerity, SIBs emerged as a new approach to scaling social programmes where impact-first investors and philanthropic funders assume the financial and performance risk of expanding preventive programmes that help specific communities of people. These risks were previously taken on by government, whereas now the government only pays if the pre-agreed targets are met. A SIB is a multi-stakeholder partnership in which a government contract for social services is structured as a pay-for-performance contract. The first was launched in the UK in 2010, so it is arguable whether there is any objective evidence showing if they are effective or not, particularly as the first UK SIB was terminated prematurely because of a change in government policy. Investors to date have largely been charitable foundations and high-net-worth philanthropists.

A different approach was taken by Perth (Scotland) YMCA with the Living Balance SIB. The Perth and District YMCA recruited 12 ‘involved’ investors whose interests were greater than simply financial ones and were either local businesses or local people with direct, vested interests in the social outcomes of the SIB and who offered their own skills and resources as well as money. Each investor contributed between GBP 5 000 (approximately EUR 5 550) and GBP 50 000 (approximately EUR 55 510), and most were not previous YMCA donors.

Documentation for bigger SIBs can be very complex and can require all parties involved to develop new skills. External intermediaries are often involved in providing support, especially for the soft parts of the contract for which there is often no budget. An independent assessor is also required to set performance targets and provide an objective review. They are not bonds, but rather financial contracts entered into with a special-purpose company, offering repayment based on schedules and outcome metrics that vary one from another.

SIB intermediary Instiglio has published the first legal road map for SIB practitioners. Instiglio classifies SIBs into three stages of development:

- exploration, where stakeholders have expressed interest but at least one criterion for moving to the design stage is missing;
- design, where there is public information about the bond, publicly available information about the social issue and target market and equally available information about the location, but where services have not started;
- implementation, where service provision has started ⁽¹⁷⁷⁾.

Relevance: (MEDIUM) To date, SIBs have been focused on third sector organisations, often charities, and intermediaries monitoring the programme being funded. Distinctive social enterprise engagement has been low.

175 Social Enterprise Code (2019).
176 Canadian Centre for Social Innovation (2019).

177 Instiglio (n.d.).

Feasibility: (MEDIUM) SIBs are only just emerging from the incubator phase. There has been a lot of hype and less action. The US experience has seen Goldman Sachs investors and the Bloomberg Foundation lose money, but the Perth YMCA SIB is demonstrating a positive retail approach. The use of the word 'bond' implies low risk and may be a misnomer; SIBs are not low risk. If you are a very risk-tolerant investor and want to support innovation in social intervention, these may appeal. However, as with other instruments, be prepared to hold to maturity. In some countries, SIB intermediaries have emerged to foster collaboration among stakeholders and to design products that address specific social or environmental issues.

2.9.5. Development impact bonds (DIBs)

A variation of the SIB that is being worked up is the **development impact bond (DIB)**. These are intended to provide up-front funding for development programmes by social investors, who are remunerated by donors or host-country governments, and who earn a return if evidence shows that programmes achieve pre-agreed outcomes. If interventions are not successful, investors lose all or some of their money.

Relevance and Feasibility: See SIB comments above and outcomes funds in the general glossary. The market is, however, even more undeveloped and raises many issues.

2.9.6. Direct lending funds

Direct lending funds are a new source of finance, fuelled by the growth of crowdfunding and the alternative finance market. Such funds provide unitranche financing where borrowers are given senior and junior debt combined in one tranche bearing a blended interest rate. This can lead to more flexible terms and covenant-lite features. You can see whether loan origination by funds is permitted in your area by consulting Direct Lending in CEE/SEE ⁽¹⁷⁸⁾.

Relevance (MEDIUM): Direct lending creates a direct relationship between the lender and borrower, although it can also be done through pooled funds led by an intermediary. Although often more expensive than mainstream debt, it is generally available when bank debt is not.

Feasibility (LOW): It is becoming an increasingly active part of the alternative finance market as investors seek new homes for their money to earn higher rates of return, but it has yet to extend more widely into social enterprise as tangible security may not be available in sufficient amounts.

3. Semi-repayable finance

3.1. Loan guarantees and loan guarantee funds

These can either be direct guarantees to intermediaries that provide finance, or counter guarantees to intermediaries who issue guarantees. They share in the risk of an initiative and can cover financial risk, economic risk or performance risk, or they can unlock an advance payment. By sharing risk, they make it easier for intermediaries to fund new sectors and allow lenders to take additional risk by offering improved terms. There is acknowledged good practice in the provision of guarantees, as outlined below.

- The optimum percentage of risk covered by the guarantee should be 50-80 %. Less than 50 % is likely to be unattractive to the lender unless they have a specific first risk they want covered. Above 80 % has created moral hazard in the past, as lenders lost their incentive for full due diligence and for speedy recovery. Also, if the risk is too high, the guarantor may decide to act as the lender directly. Guarantees may cover all the sums involved, for example, principal, interest, fees, penalties and legal fees in event of non-payment. These are 'uncapped' guarantees. In other cases, the guarantor may limit their commitment to a finite amount of money, a cut-off date or a ranking of payment vis-à-vis others. These are 'capped' guarantees. If uncapped, the price is higher. Capped guarantees are provided for free under European programmes such as EaSI.
- It is important to establish a clear line of risk, as defined by the order of the lender claims from the various parties and who has responsibility for issues such as the validity of the loan contract and enforceability of the guarantee.
- The size of the guarantee is most commonly defined as a fixed percentage of the unpaid part of the loan principal, plus interest payable at the moment the guarantee is called. It may also extend to cover legal and enforcement costs.
- Duration of the guarantee is usually 6 months after the termination date to allow for any possible legal or other claims.

The Bill & Melinda Gates Foundation issues loan guarantees, rather than direct funds, to some of the enterprises it supports, recognising that this can be an efficient way to leverage its donations and provide more certain funding. Its first guarantee allowed a charter school in the US to raise USD 67 million (approximately EUR 57.7 million) in commercial debt at a low rate (reflecting the quality of the guarantee) which saved the school almost USD 10 million (approximately EUR 8.6 million) in interest payments.

Relevance: (HIGH) This type of finance can open new sources of funding for social enterprises with low collateral, but costs will be additional to the loan cost.

Feasibility: (HIGH) Such guarantees are already happening at private, institutional and EU levels. There is also an opportunity for social investors to co-invest alongside an established intermediary.

3.1.1. Communities of guarantors

Communities of guarantors have been favoured tools for values-based banks, especially those with an anthroposophical background. The bank Gemeinschaftsbank für Leihen und Schenken (GLS) in Germany, for example, sees banking as a continuous and conscious process of directing the flow of money to where it is needed in societal and human development. Individual responsibility and care for others are seen as core drivers of these processes. Community building and participation is also achieved through the creation of borrowing and guarantor communities. For example, a group of parents might want to build a school, so they form a group, not only to borrow but also so that each parent, according to their means, can provide a several guarantee for part of the loan (i.e. the parents only guarantee the part they can afford to). If they move away, it is their responsibility, together with the school, to find a new guarantor to replace them.

3.1.2. Philanthropic Guarantee Agreement (PGA)

These are pledges by affluent or high-net-worth individuals to contribute to a (microfinance) fund if one of its portfolio investments fails to repay its loan. Losses are shared on a pro-rata basis and contributions are usually tax deductible. Since 2006, the non-profit impact investing firm MCE Social Capital has experienced two partial defaults against a guarantee pool of USD 129 million as of the end of 2017 from in excess of 100 guarantors ⁽¹⁷⁹⁾.

3.1.3. Guarantee funds

Guarantee funds have been important in international development. Many social entrepreneurs are excluded from the bank system, especially where banking markets are not well diversified. A guarantee fund acts as a bridge between the entrepreneur and the local financial sector. By way of example, Fonds International de Garantie (formerly RAFAD but now Philea) brings investors who want to support social development together with its own and its partners' resources to provide a UBS Bank guarantee to the local banks ⁽¹⁸⁰⁾. In turn, the local banks provide credit to local organisations in the local currency. Their risk assessment allows them to lend two to three times the amount of the guarantee. The **start-up and micro loan guarantee instrument** is one of the financial instruments of the ESF in Estonia. It guarantees start-up and expansion capital to enterprises less than 3 years old alongside free consultancy advice. In its first 5 years to 2013, the fund had provided 304 guarantees ⁽¹⁸¹⁾.

3.1.4. EaSI Guarantee

More recently, the EaSI Guarantee Instrument has been implemented by the EIF on behalf of the European Commission. It is designed to increase the availability of and access to microfinance for vulnerable groups and microenterprises and to increase access to finance for social enterprises. The EaSI Guarantee offers capped guarantees and counter-guarantees to financial intermediaries selected through a call for proposals and due diligence. This enables the intermediary to widen its target market to include enterprises that it would not normally finance (e.g. start-ups). The instrument runs until 2023. Intermediaries include financial institutions and also 'foundations, family offices [and] social investment funds' ⁽¹⁸²⁾ authorised to provide loans/guarantees. As a result, groups of social investors and high-net-worth individuals could benefit collectively from the guarantee in balancing early-stage risks. There are also a growing number of guarantee agreements between the EIF and local banks.

179 MCE Social Capital (2017).
180 Philea (2019).
181 For more information on the ESF's use of financial instruments, see FI Compass (2019).
182 European Investment Fund (2018).

Relevance: (HIGH) The EaSI Guarantee can open new sources of funding for social enterprises with low collateral, but costs will be additional to loan cost.

Feasibility: (HIGH) Use of this instrument is already happening at private, institutional and EU levels. There is also an opportunity for social investors to co-invest alongside an established intermediary or to use the EaSI Guarantee Instrument.

3.1.5. Catalytic first-loss capital (CFLC)

CFLC is a credit enhancement tool. GIIN defines it and its three identifying features as follows.

- It identifies who will bear the first loss. Typically, the amount of loss covered is also set and agreed up front.
- It is catalytic. By improving the enterprise's risk-return profile, CFLC catalyses the participation of investors that otherwise would not have participated.
- It is purpose driven. CFLC aims to channel private capital towards the achievement of certain social and/or environmental outcomes. It may also demonstrate the commercial viability of investing in a new market.

Providers are strongly aligned with the investee enterprise's social or environmental goals and theory of change. They are therefore willing to take on greater financial risk in return for driving the non-financial objectives. Providers may also have a deeper knowledge of the target sector and geography and, therefore, a better understanding of the risks than other investors. Any investor with the appropriate motivation and risk appetite can play this role. Typically, CFLC falls to foundations, high-net-worth individuals, governments and development finance institutions.

CFLC is a tool that can be incorporated into a capital structure in several ways, as outlined below.

Instrument	Description
Equity	By taking the most junior equity position, the provider takes the first losses, for which they may earn risk-adjusted returns.
Grants	A grant provided for the express purpose of covering a set amount of first loss.
Guarantees	A guarantee to cover a set amount of first loss.
Subordinated debt	The most junior debt position in a distribution waterfall ⁽¹⁸³⁾ that has various levels of debt seniority.

Source: Global Impact Investing Network (2013)

183 A waterfall is a type of payment scheme in which higher-tiered investors receive payments (i.e. interest/principal/dividends) in full first before the next tier receives any payment. Adapted from Investopedia (n.d.b).

3.2. Quasi-equity

A number of social enterprises cannot issue share capital for legal or structural reasons, but are also reluctant to borrow, perhaps seeing indebtedness as a root of the financial crisis. Such enterprises may instead make use of quasi-equity instruments, which are financial instruments that reflect characteristics of debt and equity. In mainstream finance, mezzanine capital and risk- and revenue-sharing partnerships are relatively common. For social enterprises, such instruments, standing between what we know as equity and debt but having many of the characteristics of equity (e.g. no defined reward or return that is success dependent), are also beginning to emerge. An investor puts money into an enterprise but, rather than making a loan to be repaid in regular instalments, they buy the right to receive part of that enterprise's future revenues, known as a revenue participation agreement (see Section 3.2.3.).

In 1492, Christopher Columbus raised a significant portion of the investment he needed for what became his trip to the Americas via a quasi-equity-style investment from the Court of Spain. King Ferdinand and Queen Isabella negotiated a deal that promised Columbus a range of benefits if he succeeded, including: the rank of Admiral; appointment as Viceroy and Governor of the new lands claimed for Spain; the option of buying a 12.5 % interest in any commercial venture with the new lands; and 10 % of all revenues from the new lands in perpetuity. However, political risk was just as prevalent at the time and, in 1500, the King and Queen reneged on the deal which led to a dispute between the Columbus family and the Crown that was not settled until 1790 ⁽¹⁸⁴⁾.

3.2.1. Subordinated debt, subordinated loans and junior debt

Subordinated debt, subordinated loans and junior debt are types of loan that are repaid to investors last, but ahead of equity. Investors have a junior (subordinate) status in relation to the normal or senior debt and thus rank after the senior debt holders in any repayment. As subordinated debt is higher risk, it should carry a higher rate or yield. Risk pricing, as opposed to charging what you think the borrower can afford, is not well established among social enterprises or social investors, so this does not always happen. Subordinated debt can be structured in several ways, including 'first out', whereby the subordinated debt is paid out first once the senior lender is comfortable with the loan ratios. It may also carry an interest-free period. Subordinated debt is often viewed like equity and can provide an added layer of security in the eyes of more risk-averse investors who may, as a result, be willing to put in more senior debt. However, subordinated debt is still debt, and there will only be so much debt that an enterprise can afford to service and repay.

3.2.2. Convertible loans, convertible bonds and convertible debt

First and foremost, a convertible loan, bond or debt must be repaid. However, there are three different circumstances in which the loan or bond may be converted into equity instead of repayment. Firstly, if the lender is willing to vary the loan terms in the borrower's favour, the borrower can give the lender rights to exchange its creditor position for a stake in the enterprise at a later date. In a second, more challenging circumstance, a loan or bond can be converted into equity because the borrower's regulator requires the intermediary to bolster its capital. Thirdly, a loan or bond can be converted into equity upon the occurrence of a future funding round. Convertible loans, bonds or debt are particularly useful in cases where the enterprise is so young that a valuation is not possible and an equity price cannot be set.

3.2.3. Revenue participation agreements or notes

The borrower has a loan at an agreed-upon rate of interest (usually a floor or low rate) plus a revenue participation agreement (see Section 3.2.). The borrower is responsible for the loan repayment and whatever interest is payable, while the revenue participation flows from an agreed percentage of revenue. Guy's and St Thomas' Charity in London, for example, has made social investments based on a right to a royalty from sales of a particular product. The loan therefore channels capital into the enterprise without affecting ownership, goals or mission, while the investor is properly compensated for the risks involved. Some revenue participation agreements, however, are at total risk insofar as there is no floor interest rate. These can be used by social enterprises with mutual or other non-shareholding status. The capital in loans with revenue participation agreements is 'patient' and the risk-reward is shared. However, investors view them as risky and may want higher returns by way of compensation. A track record is often a pre-condition for enterprises, so this instrument is unsuitable for start-ups.

3.2.4. Annual turnover levy

This is a standard-term loan, but with the option for the enterprise to take a 2-year capital 'holiday' in return for paying a levy on its turnover from the end of the second year. During this 'holiday', the enterprise does not have to repay capital.

3.2.5. Social Impact Incentives (SIINC)

Developed by the Swiss Agency for Development and Cooperation and advisory firm Roots of Impact. They describe SIINC as "a funding instrument that rewards high-impact enterprises with premium payments for achieving social impact. The additional revenues can help them improve profitability and attract investment to scale". This addresses a concern that, in other circumstances, the drive for scale may compromise the generation of strong social impact.

3.2.6. A social loan

A social loan offers debt investors variable repayments linked to the enterprise's turnover above an agreed base level with an upper cap. Like an equity investor, the social lender is therefore effectively sharing in the enterprise's prosperity.

The Bridges Social Entrepreneurs Fund, for example, committed a GBP 1 million social loan to HCT Group, a social enterprise that uses surpluses from its commercial London red buses, school buses and park-and-ride services to provide community transportation for people unable to use conventional public transport. The loan has a quasi-equity feature: the Fund takes a percentage of revenues, thereby sharing some of the enterprise's risk and gains. Because the loan is tied to the top line, it provides HCT with strong incentives to manage the business efficiently. Covenants are often added to such loans to avoid mission drift from the social goals.

3.2.7. Royalty financing

A further variation of quasi-equity is royalty financing, whereby the investor takes a stake in a product or service and must be paid a percentage of the surplus in return for its investment. Long established in North America, royalty financing is relatively unknown in Europe. It has its origins in the mining sector: a mining company receives capital to build a mine in exchange for a small percentage of what the mine produces for the entire life of the mine. The royalty company therefore participates in revenue from the mine, but the mining company doesn't give up any control of the company. The model has been so successful that it has been adopted in many sectors. Typically, 'loans' last for 25-30 years but can be redeemed early. Because the royalty company takes a slice of revenue, the interests of the two partners are aligned: when revenues turn down, the royalty also reduces. Such an approach may suit social entrepreneurs who do not want to surrender control of their enterprise.

3.2.8. Surplus share

This refers to an agreed percentage of profits (surplus) from certain activities, which, if achieved, are paid to the investor in return for a loan/investment.

3.3. Mezzanine debt capital

Generally, mezzanine debt capital refers to the layer of financing between senior debt and equity and it fills the gap between the two. It can take the form of convertible debt, senior subordinated debt, private mezzanine securities, or debt with warrants. It is typically used to fund growth, for owners to take money out of the business or to enable management to buy out owners for succession purposes. When used in conjunction with senior debt, mezzanine debt capital reduces the amount of equity required. Traditional mezzanine investors are hold-to-maturity investors, generally focused on cash flow lending. To get mezzanine funding, therefore, enterprises need to be cash flow positive.

For some mezzanine loans, the financial returns to the investor are calculated as a percentage of the future revenue streams of the investee. If these are not achieved, then a floor rate – or possibly nothing – is paid to the investor. The return can also be capped and based on gross or incremental revenue. In such cases, there is no dilution of ownership.

Relevance: (HIGH) Equity-like debt addresses many of the issues facing investors and social enterprises and is essential for their growth.

Feasibility: (HIGH) Apart from any local regulatory issues, using mezzanine debt capital should be highly feasible. However, advisors have often made mezzanine debt capital – and other forms of quasi-equity more generally – complex beyond the capability of enterprise staff to implement and manage, which is likely to reduce its feasibility over time and its relevance to all but the largest social enterprises.

3.4. Hybrid finance

Hybrid finance is another term imported by investment bankers and private equity managers that refers to funding structures more complex than most social enterprises need or understand. To many social enterprises, hybrid may simply mean a structure that brings together a grant, a loan and some form of equity. A challenge for social enterprises and investors, however, has been the inability to have the following in one entity: tax-deductible donated capital; equity for which the investor seeks a market return; and quasi-invested capital (such as PRIs), which are structured as loans but have strong social impact drivers. This has led to innovative, but often complex, funding instruments that use a series of contracts and agreements to combine one or more independent businesses and third sector organisations into a flexible structure that allows the entrepreneurs to conduct a wide range of activities and generate synergies that cannot be achieved in one entity or with one instrument. Hybrid finance in this sector seeks to combine profit (for the investor) and mission (for the social enterprise).

Network and finance partner Nexus for Development, for example, works with social enterprises that are positively impacting poverty and climate change in Asia. It is developing financing solutions that blend traditional development funding with debt finance, impact investment and climate finance. One such solution is its Pioneer Facility. Through a blend of recoverable grants and impact financing, Nexus aims to fill the 'pioneer' gap (as scaling impact requires resources) by mitigating risks and providing affordable working capital. Nexus will also support up to 20 social enterprises to develop their own monitoring and evaluation systems to improve their chances of securing further funding from impact investors. Investors will be invited to have a seat on the investment committee, helping to shape its strategy ⁽¹⁸⁵⁾.

3.4.1. Mission-protected hybrids (MPH)

In Section 3.4. it was acknowledged that a corporate form that can embrace all the positive aspects of hybrid finance is challenging. One approach has seen the development of MPHs out of the Benefit corporation model. Benefit corporations require directors to consider social and environmental goals as having the same importance as financial goals. An MPH takes this a step further by requiring that the social mission outweigh profit motive and that the enterprise spend more on social mission than profit-seeking.

3.5. Initial coin offerings (ICOs)

Mimicked on the classic IPO, ICOs are fundraising models whereby enterprises use blockchain technology to issue digital assets (usually referred to as tokens or coins) in return for investment, rather than equity stakes. So far, most of the companies who raise funds through ICOs offer blockchain-based services or products. ICOs are generally much easier and faster to conduct than traditional fundraising. The funds raised are non-dilutive and they allow enterprises to take advantage of the hype surrounding blockchain technology and cryptocurrency.

There have been at least two ICOs by socially entrepreneurial start-ups. In 2017, Humaniq raised more than USD 5 million (approximately EUR 4.4 million) to use blockchain technology combined with biometrics and mobile technology to provide financial access to unbanked communities. A second enterprise, Moeda, seeks to work in a similar fashion. However, the lack of a track record to date for either party suggests that the investors buying these coins were doing so for speculative purposes rather than as impact investors. Despite this, there are growing areas

185 Nexus for Development (n.d.).

of interest in ICOs for funding platforms, supply chain solutions and identity solutions ⁽¹⁸⁶⁾. In the US, for example, Femergy (formerly Moms Avenue) ⁽¹⁸⁷⁾ seeks to support women entrepreneurs with a blockchain-based market. But ICOs have been going through regulatory growing pains. This has led to searches for other means of funding blockchain innovation, such as **security token offerings (STOs)**. STOs are financial securities whereby the tokens are backed by something tangible, such as the assets, profits or revenue of the company, and can be traded, sold or held during the offer period.

At the time of writing (November 2018), the Financial Stability Board (European Commission) is still waiting with regard to regulation of the cryptocurrency market and, by inference, ICOs and STOs. However, the US, Japan and France are working towards developing legal frameworks ⁽¹⁸⁸⁾.

4. Equity

Equity – both internal and external – can be one of the best financial instruments for start-ups, but it can be expensive in terms of control and mission.

4.1. Internal equity

Starting an enterprise with just your own capital is known as **bootstrapping**. Such internal equity comes from within the enterprise and is therefore not subject to dilution or possible mission drift. **Historic surpluses (money made in previous years and retained in the organisation)** can be used to invest in new ideas, market research for a new market, etc. For example, a cooperative could set up a **trust fund** into which it pays a 5 % ‘withholding’ applied to all goods and services bought from members. The trust money is then used as equity to secure loans. When the loans are repaid, the members can have their retentions released or reinvested. Another option for internal equity is to set up an option pool for staff, present and future, who may wish to buy in later at a discounted rate.

Relevance: (HIGH) Unrestricted capital is high quality.

Feasibility: (LOW) Many social enterprises have not built sufficient surpluses to be able to reinvest.

4.2. External equity

In return for an external equity investment, the investor generally expects to receive shares in the enterprise. These shares can carry rights, including the right to vote on company matters. In a company structure, the investor would expect to receive voting rights proportionate to ownership. However, a cooperative usually operates under a democratic structure of one vote per investor, regardless of the size of the investment. Very few social enterprise shares are quoted on exchanges or traded, so private equity investors may look for a trade sale (i.e. the sale of the enterprise to another business) as their preferred exit route.

When deciding whether to use equity, there are several issues that all parties need to consider:

- the compatibility of the respective missions;
- the potential impact on the culture of the enterprise;
- the relationships with other stakeholders;
- dilution of ownership;
- what the investor brings in addition to money (if anything);
- amount of profit participation the investor expects and over what time horizon;
- the investor’s exit strategy (if any);
- the impact of the investment on the social enterprise’s legacy.

In a company structure, there may be two main types of share: **ordinary shares**, also called **common equity**, and **preference shares**. In social enterprises, finance-first investors are more likely to take preference shares, which give them first call on a dividend when there is sufficient surplus to pay one. The preference may be cumulative, so that rights roll up until the dividend is paid, or non-cumulative, where prior years’ non-payment are ignored. In return for this preference, these investors may have lesser voting rights, which may offset concerns about mission drift. As with debt, there are other types of external equity, as described below.

4.2.1. Depository receipts

Social enterprises can protect themselves and their mission by having a foundation own all the issued shares (and therefore the voting rights). They may still wish to raise further funds by ways of non-voting capital. They can do this by issuing so-called depository receipts. These represent the enterprise’s equity and are tradable with a value determined by the issuer or the market. This is the way Triodos Bank raises new capital without diluting its mission or ownership. All the ordinary shares of the bank are held in a special trust that controls all the voting rights conferred by the shares. This ensures that decisions about financial profit cannot be taken at the expense of the bank’s social and environmental goals. The average annual return for shareholders over the past 5 years has been 4.3 %.

4.2.2. Cooperative shares

Cooperative societies are run for the mutual benefit of members who use its services. Their capital is in the form of member shares (subscribed by the members) which are often redeemable. Membership is open to users. The UK financial regulator, the Financial Conduct Authority (FCA), has recently permitted cooperatives to have investor members who are not otherwise users of the cooperative’s services. A cooperative can pay interest on member share capital and a share of any surplus (dividend). In Switzerland, the financial authorities have given the WIR, the

186 For more information, see UK Parliament (2018).
187 Femergy (2019).
188 For more information and monthly updates on the regulatory environment, follow Phil Glazer via Medium.

alternative currency system and coop, permission to have membership shares and separate non-voting financial shares, similar in intent to a preference share. The regulator has split the governance and financial elements.

4.2.3. Community shares

Many social enterprises serve local communities and set themselves up as mutual community benefit societies. A community benefit society is run primarily for the benefit of the wider community, rather than just its members. Community shares have been used to finance shops, pubs, community buildings, renewable energy schemes, local food schemes and sports clubs. The risk capital comes from the very community that an enterprise is seeking to benefit. As with any other form of finance, the enterprise must develop a sound business case. It then has to win the support of the community, establish appropriate governance structures and draft a share offer document. Although it has the power to pay interest on members’ share capital, a community benefit society cannot distribute surpluses to members in the form of dividends. It can also opt to have a statutory asset lock (i.e. a device preventing distribution or use of assets for private gain), which is not available to cooperatives.

While there are community share initiatives in the wider EU, the UK is recognised as the market leader. The Community Shares Unit (CSU) and the FCA are working together to recognise/promote good practice through a Standard Mark. The CSU has also published the Community Shares Handbook ⁽¹⁸⁹⁾. It is a joint initiative between Locality (formerly the Development Trusts Association) and Cooperatives UK. The Community Shares Company provides practical advice and support in working towards a community share offer. Since 2009, more than 300 societies in the UK have raised more than GBP 60 million in share capital to support local, member-owned businesses.

A growing number of community share issues are now raised through crowdfunding platforms. The Co-operative’s Community Shares Fund can also help initiatives and underwrite a share issue, which is useful if local social investors wish to pay for their shares in monthly instalments

4.2.4. Direct public offering (DPO)

Currently specific to the US, a direct public offering is similar to an IPO in that securities such as stock or debt are sold to investors but, unlike an IPO, the enterprise raises capital directly without an underwriting intermediary. Most DPOs also do not require Securities and Exchange Commission (SEC) registration because they are valued at less than USD 1 million. They are used primarily by small enterprises who want to raise capital from their own community. While some DPOs are being offered on crowdfunding sites, they are typically registered and undergo some degree of regulatory scrutiny. An example is Food Commons Fresno’s ⁽¹⁹⁰⁾ offering memorandum from 2017 to raise USD 4.5 million (approximately EUR 3.87 million) by way of preference shares, 2 % promissory notes and pre-paid purchase cards redeemable for 150 % of face value solely from residents of California.

Relevance: (HIGH) For those social entrepreneurs that choose a cooperative model rather than a limited company structure, and who wish to engage with their local community of place or interest, these instruments can be highly relevant. Although investors will need to be aware that the challenges around mission and control notwithstanding, equity is capital at risk.

Feasibility: (HIGH) Different types of equity are available for different structures.

189 Community Shares (n.d).
190 Food Commons Fresno (n.d).

Glossary of other terms

Social investment and enterprise are not immune from the use of jargon, terms, acronyms and words that you may not have come across before – or at least not in the way they are used by social investors and entrepreneurs. ‘Lost in translation’ is a frequent refrain, so we hope you will find this part of the guide useful. We are grateful to EVPA and ClearlySo for much of the source material.



Alternative Commission on Social Investment

The Commission was set up in 2014 in the UK by Social Spider CIC under a grant from the Esmée Fairbairn Foundation. Its objective was to investigate what’s wrong with the UK social investment market and to make practical suggestions for how the market can be made more accessible and relevant to a wider range of charities, social enterprises and citizens working to bring about positive social change. The Commission brought together leading experts on social finance in the UK who found that the sector lacks transparency and wider relevance. It produced 10 key recommendations in 2015.

Angel investor (also known as business angel)

An individual who invests their own money – usually as equity, sometimes as debt – in a start-up to help it grow. They might invest entirely on their own or as part of a group of ‘angels’ or a syndicate. An impact angel investor is someone who wants to invest for positive social or environmental impact.

Appetite

Often used in connection with risk or portfolio concentration, ‘appetite’ refers to an investor’s desire for or degree of openness to something. To have an appetite for risk, therefore, is to be open to taking more risk. To have an appetite within a portfolio is to indicate a willingness to increase certain investment types.

Artificial intelligence (AI) (also known as machine intelligence)

Deals with the automation of intelligent behaviour and machine learning. It is the intelligence displayed by machines, in contrast to the natural intelligence displayed by humans and other living beings. AI was founded as an academic discipline in 1956, but has seen waves of optimism followed by disappointment. In the 21st century, AI has experienced a resurgence on the back of more powerful computers, large data and theoretical understanding. AI is considered to be one of the driving forces of the digital revolution ⁽¹⁹¹⁾.

191 European Commission (2018).

Balanced scorecard

A strategic planning and management system that organisations use to align day-to-day work with strategy; to prioritise projects, products and services; and to measure and monitor progress towards strategic targets ⁽¹⁹²⁾. The system translates strategic elements such as vision, mission or values into more operational elements, such as objectives, targets and key performance indicators (KPIs), and thereby helps people identify what should be done and measured. It was developed by Professor Robert Kaplan of Harvard Business School and Dr David Norton in 1992.

New Profit ⁽¹⁹³⁾, in partnership with Professor Kaplan, has adapted the balanced scorecard for the third sector by adding the ‘social impact’ perspective.

Balance sheet

A financial statement that shows an enterprise’s value at a given point of time by detailing what is owned and what is owed. It is historic, and you therefore need to check whether the same basis for calculation has been used from year to year and what, if anything, has been excluded.

Base/bottom of the pyramid (BoP)

An economic term referring to the largest but poorest socio-economic group in the world: the 4 billion people who live on less than USD 2.50 per day. One of the earliest popular uses of the phrase ‘bottom of the pyramid’ was by US president Franklin D. Roosevelt in his 1932 radio address ‘The Forgotten Man’, which referred to the plight of the American farmer and the importance of building economic power from the bottom up, rather than from the top down. The more contemporary usage of the term is attributed to C.K. Prahalad, who introduced the idea of this population as a profitable consumer base in his 2004 book *The Fortune at the Bottom of the Pyramid* ⁽¹⁹⁴⁾.

Below-market return

Level of return on investment (ROI) that is lower than the average level of return offered by the financial market for an investment with the same risk profile.

Blended finance

Blended finance is the strategic use of development finance for the mobilisation of additional finance towards sustainable development in developing countries ⁽¹⁹⁵⁾.

Blended Value

As defined by Jed Emerson, who coined the term, ‘the Blended Value Proposition states that all organisations, whether for-profit or not, create value that consists of economic, social and environmental value components and that investors [whether market-rate, charitable or some mix of the two] simultaneously generate all three forms of value through providing capital to organisations’. The outcome of all this activity is value creation and that value is itself non-divisible and, therefore, a blend of these elements ⁽¹⁹⁶⁾.

Blockchain

Blockchain technology uses cryptographic methods and consensus protocols in a decentralised network to store transactions. These transactions are transparent, immutable and usually linked to a cryptocurrency. Over the years, the field has developed different systems based on the blockchain technology with varying degrees of privacy, speed and cost. It has been used for fundraising, as well as a range of interesting concepts such as transparency in supply chains or impact-based payment mechanisms.

Bootstrapping

When an entrepreneur starts and grows a venture using only their own personal finances and the venture’s revenues.

Builder finance

Using the terminology of George Overholser ⁽¹⁹⁷⁾, ‘builder finance’ refers to the need for finance to take on necessary staff and for products to be developed and adapted to meet customer needs and market conditions. It is finance provided by investors who are prepared to accept only social returns for an initial period without requiring any financial return and who therefore accept a high risk of capital loss. The investor may wish to provide an instrument that converts into providing a financial return once the enterprise has achieved certain benchmark criteria for revenues and/or financial surplus. This relationship may last many years. In Europe, builder finance remains aspirational rather than delivered.

Business model

A tool for the describing, analysing, managing and communicating of a company’s value proposition to its customers and stakeholders, and how it creates, delivers and retains this value in the successful operation of its business, identifying revenue sources, customer base, products and details of financing. There are a variety of business models. Traditional for-profit models have an ability to generate profit for their owners, while traditional charities and NGOs seek to have the ability to generate positive change in the world. By and large, social enterprises seek to apply a balance between profit generation and positive change (social impact). A **social enterprise model** is a framework that an enterprise follows to bring about (measurable) positive social change while maintaining financial sustainability within a sound governance structure. Examples can include the:

- entrepreneur support model
- market intermediary model

192 Balanced Scorecard Institute (2019)

193 New Profit (2019).

194 Coherence Collaborative (n.d.).

195 Organisation for Economic Co-operation and Development (n.d.).

196 Emerson (2003).

197 Overholser (2010).

- employment model
- fee-for-service model
- low-income client model
- cooperative model
- market linkage model
- service subsidisation model
- organisational support model ⁽¹⁹⁸⁾.

Business plan

A formal statement of business goals, reasons they are attainable and plans for reaching them. A social enterprise business plan will also include the mission statement of the enterprise and the importance of meeting both the financial and social goals.



Capacity building (also known as organisational development or resilience building)

An approach aimed at strengthening organisations to increase their overall performance by developing skills or improving structures and processes. (See also Investment readiness.)

Capital expenditure (Capex)

Funds used by a company to acquire, upgrade, and maintain physical assets such as property, industrial buildings or equipment. Capex is often used to undertake new projects or investments by the firm. This type of financial outlay is also made by companies to maintain or increase the scope of their operations ⁽¹⁹⁹⁾.

Capital

Refers to all types of wealth owned by an entrepreneur or a venture, including cash and assets. Other forms of capital can include (but are not limited to) property, equipment, human resources and intellectual property. It is a word much misused amongst social enterprises.

Capital readiness

The ‘preparedness’ of an enterprise to take on new capital (investment). With its focus on capital in any form, it is a subset of investment readiness.

Carbon finance

Carbon finance is the general term applied to resources provided to a project to purchase greenhouse gas emission reductions. There is a Carbon Finance Unit in the World Bank and there are several regulatory frameworks and markets ⁽²⁰⁰⁾. Carbon finance can make new technologies using renewable energy resources and climate-smart agricultural methods (areas in which some social enterprises work) more affordable ⁽²⁰¹⁾.

Cash flow statement

A financial statement that shows the actual cash that flows in and out of the business to pay for expenses or cash that is received as revenue. It is not a profit and loss statement. It is one of the most critical documents that investors wish to see before investing.

Certified B Corporation (B Corp)

Certified B Corporations are for-profit companies that have the B Corporation certification. The ‘B’ stands for beneficial (i.e. to society) and indicates that the certified organisations voluntarily meet certain standards of transparency, accountability, sustainability and performance, with the aim of creating value for society. Philosophically the same as legally designated benefit corporations, they have a few important differences. The B Corporation certification is not conferred by the state but by B Lab: a US non-profit organisation that promotes the power of business to solve social and environmental problems. B Lab certifies companies the same way TransFair certifies Fair Trade coffee, for example. Certified B Corporations earn their designation by meeting a high standard of overall social and environmental performance. As a result, Certified B Corporations have access to a portfolio of services and support from B Lab, which benefit corporations do not have. Unannounced audits are done on about 10 % of all certified B Corporations every year. B Corporations were launched in Europe in 2015 and include Charity Bank and Triodos Bank among others.

Charity, charitable organisation

A charitable organisation is a type of non-profit organisation. It differs from other types of non-profits in that it centres on non-profit and philanthropic goals as well as social well-being (e.g. charitable, educational, religious or other activities serving the public interest or common good) ⁽²⁰²⁾. In many countries, charity and charitable activities are defined in law and in some may carry tax exemptions, in particular if they have a public benefit status.

Co-investment, co-funding

In private equity, co-investment is the syndication of a financing round or investment by other funders, alongside a private equity fund. In venture philanthropy, it involves the syndication of an investment into a third sector organisation by other funders (e.g. grantmakers or individuals), alongside a venture philanthropy organisation. In

198 You may wish to drill down further by reading Osterwalder and Pigneur (2010).
199 Investopedia (n.d.c).

200 Fimarkets (2019).
201 Hivos (n.d.).
202 Wikipedia (n.d.b).

loan finance, it often refers to the layering of a transaction, where a senior debt provider may co-invest alongside a subordinated debt lender and a grantmaker, or another mix of different risk-takers.

Collateral, security

Collateral, also called security, is an investee’s pledge of specific property to secure repayment of an investment. The collateral acts as protection for an investor against an investee’s default.

Collective impact

Collective impact is the commitment of a group of actors from different sectors to a common agenda for solving a specific social problem, using a structured form of collaboration. The concept was first articulated in 2011 in the Stanford Social Innovation review by John Kania and Mark Kramer, co-founders of global consulting firm FSG. Collective impact is based on the idea that organisations create cross-sector coalitions in order to make meaningful and sustainable progress on social issues ⁽²⁰³⁾.

Community development finance institution/initiative/intermediary (CDFI)

CDFIs are private financial institutions that are wholly dedicated to delivering responsible, affordable lending to help low-income, low-wealth and other disadvantaged people and communities to join the economic mainstream. To be sustainable, CDFIs are profit-making but not profit maximising. The CDFI industry has four sectors: banks, credit unions, loan funds and venture capital funds. They are well established throughout the US and the UK and are recognised in other parts of the world.

Community interest company (CIC)

In the UK, a CIC is a legal status for social enterprises. A CIC comes in two principal legal forms: as a share company, which can be public or private; and as a non-profit entity without shares. A CIC must have a purpose that benefits a community and its objectives will often specify exactly what community is the intended beneficiary ⁽²⁰⁴⁾. The key features of a CIC are an asset lock, which means that assets and profits must be used for community – not personal – benefit, and a community interest statement and report that must be lodged with the CIC regulator to certify that the company is serving the community. CICs have proved popular, with about 10 000 registered in the first 10 years. Currently in the UK, the model could be legislated more widely. Other statuses for social enterprises, which can be obtained through a number of different legal forms and which comply with a number of pre-defined criteria, include the **Social Purpose Company (SPC)** in Belgium, the Entreprise Solidaire d’Utilité Sociale (ESUS) in France, and the Social Enterprise Ex-Lege in Italy.

Community shares

Restricted to cooperatives and community benefit societies, community shares are shares in enterprises that serve a community purpose and are usually bought by members of the community themselves. They are usually redeemable, are of a fixed term and carry a low interest rate or income that may be supplemented by in-kind benefits.

203 Collective Impact Forum (2019).
204 European Social Enterprise Law Association (2015).

Company limited by guarantee (CLG)

The CLG is a legal form that can be found in the UK, Ireland and Cyprus, and which is aimed at non-profit organisations that require a legal personality. A CLG usually has no share capital or shareholders, but instead has members who act as guarantors, committing to pay a nominal amount (typically very small) in the event of the liquidation of the company. They are usually set up to serve social, charitable, community-based or other non-commercial objectives and typically retain any surplus income for reinvestment. Some impact-focused business owners register their company without share capital or shareholders. The company’s liabilities are limited by guarantees, often nominal, from the members or directors. Many charities using enterprise models adopt this form. Debt is suitable for such companies.

Core costs

Recurring expenses generated by the operation of an organisation that are not directly related to the level of activity, as opposed to specific project or programme costs.

Corporate social responsibility (CSR)

CSR is a form of voluntary corporate self-regulation and relates to a company’s engagement in actions that appear to further some social good, beyond the interests of the firm and the requirements of the law. CSR efforts are integrated into the business model and consider not only shareholders, but also stakeholders, such as employees and customers. CSR efforts often include the entire value chain, including suppliers, buyers and the communities in which the company operates, when addressing issues of social and environmental impact. The term ‘corporate social responsibility’ came into common usage in the late 1960s and early 1970s after many multinational corporations coined the term to describe any group that is impacted by a company’s activities. Annual CSR reports are now published, using a framework such as GRI (Global Reporting Initiative) to increase awareness and transparency around CSR and sustainability progress. CSR is not seen as part of social investment.

Corpus

The corpus is the original gift and ongoing principal that form the asset base from which a foundation or fund operates ⁽²⁰⁵⁾.

Credit enhancement

Credit enhancement is commonly used in traditional finance markets to improve the credit worthiness of a particular investment. It can take various forms: from bank letters of credit facilitating trade finance, to government loan guarantees to boost business growth. In the social investment market, some investment opportunities that have strong potential for social or environmental impact are perceived as having high financial risk. Others may suffer from a lack of information or track record. Credit enhancement can encourage the flow of capital to such needs by improving the risk-return profiles. There are several tools that can be used to provide credit enhancement, examples of which are included in this guide. They include letters of credit, first-loss capital, over-collateralisation, insurance and reserve accounts. See also **Catalytic first-loss capital** in the Glossary of financial instruments.

205 Burke Smith (2012).

Crowdfunding

Funding that pools often small contributions from lots of individual investors via an online platform. It can involve donations and/or in-kind rewards, or it can be debt and equity. The latter two are regulated ⁽²⁰⁶⁾. In return for their contributions, the crowd can receive a number of tangibles or intangibles, which depend on the type of crowdfunding. (See also Chapter 3 and Annex 6.)

D

Deal flow

Deal flow refers to the number and/or rate of new proposals presented to an investor.

Deal pipeline

Deal pipeline refers to the number of initiatives an investor is working on and/or expects to come down the line. If this is growing, the investor may have to reconsider their resources.

Debentures/convertible debentures

Debt instruments, usually medium to long term, that are not secured by physical assets or collateral but by the general creditworthiness and reputation of the issuer (investee). Convertible debentures are loans that can be converted into equity by the investor and, under agreed circumstances, by the issuer. If adding the convertibility option, the issuer should pay a lower rate of interest.

Debt financing

Debt financing is borrowed money used to finance a business, either a traditional enterprise or a social enterprise. Debt is usually divided into two categories: short-term debt for funding day-to-day operations and long-term debt to finance the assets of the business. The repayment of short-term loans usually takes place in less than 1 year. Long-term debt is repaid over a longer period. (See also [Loan](#).)

Depository receipts

In the context referred to in this guide, depository receipts are issued by social enterprises or other values-led companies where the voting equity is already tightly held. They represent shares in the enterprise and are designed to safeguard its mission and independence. Depository receipts are issued on behalf of the enterprise by the entity – usually a foundation – that owns the voting shares. The holders of the depository receipts are entitled to dividends, but the receipts are not quoted on any exchange. To overcome the lack of an open market in depository receipts, the enterprise or a financial intermediary tries to match willing buyers and sellers.

206 European Parliament (2017).

Depository receipts are sometimes also known as ADRs (American Depository Receipts) in acknowledgement of the fact that they have been used actively in the US since the 1920s.

Dilution

The reduction in the percentage of ownership of an enterprise that investors may suffer when new equity is raised.

Double bottom line

A business term used in socially responsible enterprise and investment to refer to both the conventional bottom line (a measure of fiscal performance) and a second bottom line: a measure of positive social impact.

Due diligence

The process whereby an organisation’s or company’s strengths and weaknesses, assets and costs, benefits and risks are assessed in detail by a potential investor with a view to investment. Due diligence needs to be undertaken conscientiously and painstakingly if it is to contribute significantly to informed decision-making by enhancing the amount and quality of information available to decision makers.

E

Ecosystem

The Encyclopaedia Britannica defines an ecosystem as ‘the complex of living organisms, their physical environment and all their interrelationships in a particular unit of space’ ⁽²⁰⁷⁾. This analogy has been adapted to many sectors of life. The ecosystem that supports social finance represents a confluence of actors and institutions. Collectively, these support the actors through sourcing, facilitating, intermediating, structuring, supporting and promoting research and investment.

Where individual deals are smaller and can have higher overhead costs as a percentage of financial return, they cannot rely exclusively on indiscriminate market forces, but may require financial and other support functions. The social finance ecosystem represents a broad variety of financial institutions, private research and consulting organisations and investors, each with distinct functions, investment mandates, funding sources, liquidity requirements, time horizons and liability structures. Most importantly, each actor in the ecosystem may have a different approach to balancing and managing the risks and financial and social returns of a social investment ⁽²⁰⁸⁾.

207 Encyclopaedia Britannica (n.d.).

208 Roose and Bishnoi (2012).

Environmental, social and governance criteria (ESG)

ESG is a catch-all term that encompasses the major areas of concern for a business that strives to operate in a sustainable and ethical manner. In addition to financial factors, each of these areas is taken into consideration for anyone considering investing in a company.

Equity financing

Funding provided by an investor to an organisation that confers ownership rights on the investor. These rights allow the investor to share in the profits of the organisation, usually in the form of dividends. Equity investors are diverse and can include the organisation's founders, friends, family, institutions and angel investors. Venture philanthropy funds may provide a source of equity financing for social enterprises. Newer, and still experimental, means of ownership (e.g. a community interest company in the UK) allow equity purchase but place a cap on the financial return. (See also Quasi-equity.)

Exit

The end of the relationship between the investor and the enterprise. The nature of the exit will normally be agreed upon before the investment is completed. In the case of a charity, the funder will ideally be replaced by a mix of other funders. The time scale for the exit can be agreed upon at the outset. In the case of a social enterprise, exit may require the repayment of a loan, for example, and the timing will depend on the commercial success of the enterprise. Exit may be the result of a trade sale of the enterprise to another social enterprise or, more commonly, a commercial enterprise. (See also Financial sustainability.)

F

Finance-first investing

In the spectrum of impact and return, finance-first investors prioritise financial return above social impact.

Financial instrument

The method of and tools used in providing finance to an enterprise, examples of which are included in the Glossary of financial instruments. Depending on the context, financial instruments can be defined to include only repayable finance or they can be broader and include grants.

In the context of the Employment and Social Innovation pilot projects, a financial instrument is one that seeks to address specific policy objectives of the EU and may take the form of equity or quasi-equity investments, secured or unsecured loans, guarantees or other risk-sharing instruments, grants and other types of participation in an enterprise.

In the context of the European Social Fund, financial instruments:

- are expected to be repaid;
- are revolving (i.e. with funds repaid being used again in the same area);

- are suitable for financially viable projects (i.e. those that are expected to generate enough income or savings to pay back the support received);
- are designed to attract co-investment from other sources, including private investment, to increase the amount of funds available in sectors/areas where there are problems with access to finance;
- can take the form of loans, guarantees or equity;
- can also support supply-side development by contributing to the development of the market;
- may be used in a complementary way with grants;
- may be managed by national or regional banks, international organisations such as the EIB or EIF, by financial intermediaries and (for loans and guarantees only) by managing authorities.

Financial intermediary

An institution or contractual arrangement that facilitates the channelling of funds amongst savers, investors, lenders, donors and social enterprises.

Financial sustainability

For a social enterprise, financial sustainability is the degree to which it collects sufficient revenues from the sale of its products or services to cover the full costs of its activities. For charities, it involves achieving adequate and reliable financial resources, normally through a mix of income types.

Fintech

Any technological innovation in the financial sector, including innovations in financial literacy and education, retail banking, investment and cryptocurrencies. (See also **Techfin**.)

First-loss tranche (also known as first risk layer or loan loss layer)

A segment or layer of an investment fund or transaction that stands ready to absorb any losses up to a pre-agreed maximum. This can help to make the deal more attractive to other investors who will only be taking residual risk (i.e. risk that remains after all efforts have been made to mitigate or eliminate risks associated with the investment).

Floating charge (also known as equitable charge)

A floating charge is a charge on all the company's assets, present and future, on the basis that the company may deal with the assets in the ordinary course of business (i.e. ownership or possession does not pass to the creditor who retains the right, nonetheless, to go to court to recover the loan). It is convertible into a fixed charge, at which point the charge does attach to specific assets. Many lenders will ask for a floating charge. A floating charge can, however, become cumbersome because the availability of assets under the charge should be monitored if it is to have any value. (In a liquidation, there are rarely any assets left). It is called floating because it 'floats' over the assets.

Foundation

Public benefit foundations are separately constituted third sector bodies with no members or shareholders. They are asset-based and purpose-driven. Foundations focus on areas ranging from the environment, social services, health and education, to science, research, the arts and culture. They each have an established and reliable income source, which allows them to plan and carry out work over a longer term than many other institutions, such as governments and companies. In the context of social enterprise, foundations are third sector organisations that support social enterprise activities through grantmaking, operating programmes or programme-related investing (PRIs).

Friends and family funding

The early funding that an entrepreneur might raise from people they know well. Often these people are investing because they know and like the entrepreneur and may therefore be happy to take higher risks.

Fund

A vehicle created by a number of investors to enable pooled investment, usually managed by a dedicated organisation. It can offer one or more financial instruments (see Glossary of financial instruments).



Grantmaker

Grantmakers include institutions, public charities, private foundations, individuals and giving circles that award money or subsidies to organisations or individuals. Grantmakers also include certain types of trusts in the UK; these are generally known as foundations in continental Europe.

Grant financing

Non-returnable money, property, services or anything else of value that is transferred to an organisation without conferring any form of ownership rights on the donor. Note, however, that some investors do use ‘returnable’ grants from time to time, which may involve the return of all or part of a grant, contingent upon an agreed event. For example, a grant might be given to enable fundraising, but if the fundraising is successful or exceeds agreed-upon levels, a portion of the grant may be returned.

Green bonds

Green bonds are at the head of the class of financial innovations for environmental sustainability. They were created to fund projects that have positive environmental and/or climate benefits. The market for green bonds started in 2007 with the AAA-rated issuance from the EIB and the World Bank. In March 2013, the International Finance Corporation (IFC) issued a USD 1 billion green bond that sold within an hour of issue. The majority are green ‘use of proceeds’ or asset-linked bonds. Proceeds from these bonds are earmarked for green projects but are backed by the issuer’s entire balance sheet ⁽²⁰⁹⁾.



High-engagement funding

High-engagement funding, as defined in a seminal article by Letts and Ryan ⁽²¹⁰⁾, ‘is first and foremost a performance-centred strategy where alignment, reliable money and strategic coaching are used together to convert a purely financial relationship (by way of a grant) into an accountability relationship that uses power to improve performance. High-engagement funders believe that improving the performance of third sector organisations is the best means of achieving their social goals.’ High-engagement funding has many of the features of venture philanthropy.



Impact investing, 3D investing

A form of investment that aims to generate social impact as well as financial return. It is also known as 3D investing because it considers not only risk and return in investment decision-making, but also the social and environmental impacts. It is differentiated from responsible investing or ESG investing because it specifically seeks out opportunities to create positive social, environmental or cultural impact. It is also different from impact-first investing, which prioritises the non-financial, social impact of the investment, as impact investors currently seek higher financial returns. For the purpose of the pilot projects, the European Commission defined impact investment as ‘financial activity which has an expectation of both a specified social outcome and an explicit financial return for its investors (usually below “market rate”). This could include a wide range of financial products’ ⁽²¹¹⁾.

209 Climate Bonds Initiative has a useful explanation of ‘Green Bond Principles’ and the seven categories of green bonds; see Climate Bonds Initiative (n.d.).
210 Letts and Ryan (2003).
211 European Commission (2016).

Industrial and provident societies (also known as credit unions, community benefit societies, cooperatives or mutuals)

Alternative legal forms for organisations looking to enshrine social benefit within their organisation. In some cases, the benefit is restricted to members; in others, it is restricted to the wider community. Each form has a regulator that you will need to talk to if you want to adopt a particular form, as it may affect the way you can raise capital. (See also Responsible investing.)

In-house resources

Resources provided from within the investor’s organisation itself through its staff members or volunteers, as opposed to people within the greater network of service providers or portfolio organisations.

Innovative hybrids

A term developed by investment bankers for a popular method of hybrid financing. Innovative hybrids take a debt instrument and blend it with derivatives, such as a swap or option, whose financial returns are associated with several common economic variables. They are classically used to handle risk of all types.

A challenge for social enterprises and investors has been the inability to have, in one entity, the following: tax-deductible donated capital; equity for which the investor seeks a market return; and quasi-invested capital such as PRIs, which are structured as loans, but which have strong social impact drivers. This has led to innovative, but often complex, funding instruments that use a series of contracts and agreements to combine one or more independent businesses and third sector organisations into a flexible structure that allows the entrepreneurs to conduct a wide range of activities and generate synergies that cannot be achieved in one entity or with one instrument. Innovative hybrids seek to combine profit (for the investor) and mission (for the social enterprise).

Integrated capital (also known as staircase funding)

The coordinated and collaborative use of different forms of finance, often from different funders to support a developing enterprise. (See Chapter 3.)

Investee

The enterprise that is the recipient of financial and non-financial support. An **investment** is the use of money with the expectation of making favourable future returns. Returns could be financial, social and/or environmental. (See also **Triple bottom line.**)

Investment phase

The period between the investment of monies into the project, organisation or social entrepreneur, and the investor’s exit.

Investment proposal

The document prepared by the investor or intermediary to present a potential investment (including nature, goals and funding) to the investment committee. (See also **Key performance indicators.**)

Investment readiness

Work that helps enterprises prepare to take on debt, equity or other kinds of investment. For those that do not move on to investment as a result of such work, investment-readiness work may have helped them understand money better and to prepare business and financial models with greater confidence. Investment-readiness support can be provided by support organisations or by investors. A detailed discussion of investment readiness is included in Chapter 4. For the purpose of the pilot projects, the European Commission defined investment readiness as ‘the capacity and capability of a social enterprise to seek and utilise investment. Key elements that help to make a social enterprise investment ready include effective leadership, business planning and strategy, methods and capability to articulate, measure, assure and report on social and environmental impact, risk assessment [and] quality management ⁽²¹²⁾.

Key performance indicators (KPIs)

These are financial and non-financial, quantifiable metrics used to measure progress or achievement against the objectives of a project, organisation or company. A very common way to choose KPIs is to apply a management framework such as the balanced scorecard. (See also Investment phase.)

Layering (layered transactions)

Many investment proposals embody different levels of risk that may appeal to different types of investor. Layering is the process of structuring a transaction or series of transactions in a way that correspond to the related risks.

Lead investor

The investor who helps the investee get other investors involved. The lead can be the first, largest, most influential or simply most proactive investor. They will often take the lead on doing due diligence and negotiating the valuation.



212 European Commission (2016).

Legacy systems

Obsolete computer systems that may still be in use because its data cannot be changed to newer or standard formats, its application programmes cannot be upgraded, the software and/or hardware are no longer supported or the cost of so doing is considered too expensive. It may be short-sighted to try to bolt on new apps to a legacy system.

Leverage (also known as gearing)

Leverage is the measurement of how much extra investment (or other resources, such as public money) has been brought into an enterprise because of an initial investment. Technically, leverage is also a measure that shows the extent to which an enterprise's operations are funded by lenders rather than equity. In EU financial terminology, the 'leverage effect' is the ratio between the financial resources allocated to a financial instrument (input) and the finance provided to eligible beneficiaries (output), which in this context refers to social enterprises.

Limited company (Ltd.) (also known as a public limited company (PLC))

A limited company has shareholders as well as company directors and can take on equity or debt investment. A PLC is a limited company that is traded publicly on a market or stock exchange.

Loan

A sum of money lent at interest, where financial return is sought. However, it is common for venture philanthropy organisations and foundations to provide loans at reduced interest rates or to have other 'softer' features, for example regarding repayment terms. (See also [Debt financing](#).)

Long-term investment

An investment made over a period of five years or more. An example is mezzanine financing, which is a hybrid of debt and equity financing, usually used to fund the expansion stage of an organisation. Although a long-term investment is similar to debt capital, it is normally treated like equity on an organisation's balance sheet. (See also Short-term investment.)

Low-profit limited liability company (L3C)

A legal structure for businesses in the US that bridges the gap between non-profit and for-profit investing. L3Cs use their for-profit efficiencies along with fewer regulations from the Inland Revenue Service (IRS) to achieve socially beneficial goals. They operate with a stated goal of achieving social improvement, with profit as a secondary goal. L3Cs are taxed.

M

Market failure

Where the market is not interested in providing or does not supply goods or services into a marketplace or where the allocation of goods and services by a free market is not efficient from the societal standpoint, often leading to a net social welfare loss, to ecological costs and health costs. The market, usually private business, may see no or little profit in it or may consider the risks too high for the return. Market failure happens more often in excluded, remote or marginalised communities.

Memorandum of understanding (MoU or MOU)

A formal agreement between two or more parties. MoUs are not legally binding but carry a degree of mutual respect, stronger than a gentlemen's agreement. In the context of the pilot projects, the European Commission defined a MoU as a document committing the partners of a social finance initiative to contribute to the development of a social finance market or the establishment of a specific social finance instrument. The document had to specify the purpose, common objectives, investment strategy, joint working modalities and work programme, as well as the roles and contributions of the partners.

N

Negative screening

Negative screening is the exclusion from a fund or investment of companies whose activities are unacceptable or controversial ⁽²¹³⁾, or those that do not comply with the fund's environmental or socially responsible criteria.

Neo-bank

A neo-bank is something that looks like a bank but isn't. Amazon could be a neo-bank because of its ability to provide a range of financial services to its suppliers.

Near bank

A near bank is something that performs a function traditionally associated with banks, but isn't a bank and doesn't look like a bank, such as Transferwise.

Non-financial services (also known as value-added services)

In addition to providing financial support, investors, intermediaries or support organisations may provide value-added services, such as strategic planning, marketing and communications, executive coaching, human resources advice and access to other networks and potential funders. Such non-financial support is offered by volunteers, staff, donors or third-party consultants.



Outcomes

The ultimate change(s) to people's lives that the social enterprise is trying to achieve, resulting in changes to the social system, or impact. This might include changes in attitude, behaviours, knowledge, skills or status.

Outcomes funds

This is a broad categorisation for outcomes-based funding instruments, such as development impact bonds. Traditionally, donors' aid was provided for inputs regardless of final impact. The increasing need to demonstrate value for money in the use of taxpayer resources is encouraging donors to focus on, and pay for, outcomes or at least outputs and results that are a proxy for outcomes. Moving from project input funding to programmatic outcomes can drive a longer-term and more strategic approach to commissioning. At its simplest, an outcomes fund pools development finance (or finance relating to another strategic policy area) from one or more funders in support of a set of pre-defined outcomes ⁽²¹⁴⁾. Payments from the fund only occur if specific criteria agreed ex ante by the funders are met. There are two broad categories of funds: thematic and innovation. (See also Annex 4.)

Outputs

Results that a company, non-profit or project manager can directly assess or measure.

Overdraft (also known as line of credit)

A popular form of working capital finance. An overdraft is a line of credit agreed by the bank and the enterprise that allows the latter to overdraw their account. If the limit is broken, the penalty interest charges can be substantial. Breaking the terms could also lead to the overdraft being cancelled. Overdrafts are withdrawable and repayable on demand. The bank will expect the overdraft to be repaid and the account balance to return to a positive figure from time to time, as evidence that it is not becoming core term debt. Overdrafts usually require minimal documentation.



Patient capital

Another form of long-term capital. The investor is willing to make a financial investment in an enterprise with no expectation of financial return in the near term. The investor defers any financial return usually until agreed targets are triggered, such as an agreed level of turnover. In the meantime, the investor focuses on the social impact that the enterprise is achieving. Repayment can be triggered, or interest called, if the enterprise fails to meet its social impact targets.

Platform cooperatives

A term coined by New School professor, Trebor Scholz in 2014 ⁽²¹⁵⁾. Platform cooperatives combine a cooperative business structure with an online platform to deliver a real-world service; for example, if Uber were owned and governed by its drivers or Airbnb were owned and governed by its hosts. There are a growing number of platform cooperatives around the world, such as Fairmondo, a digital, cooperative version of eBay that has funded itself through a series of successful campaigns raising hundreds of thousands of euros in member equity. Another example is Enspiral, a collective of social enterprises and freelancers that makes, uses and distributes free apps for decision-making and budgeting.

Pooling

The purpose of pooling is to spread financial risk across a number of investors. It is a core function of health financing policy where it spreads the financial risk across the whole population. Pooling can open new sources of funding by tailoring liabilities to the needs of different kinds of investors. For example, Switzerland-based social capital investor BlueOrchard assembles portfolios from many microlenders and bundles them into three tranches. The bottom tranche is BlueOrchard's equity, which offers high returns but takes first loss. The second tranche takes the second loss, after equity is wiped out, and is analogous to a convertible bond. This tranche offers a lower expected return but has less risk. The top tranche offers a low but relatively safe return and is purchased by conventional debt investors. The pooling model has spread globally.

Portfolio

A portfolio is a collection of initiatives and/or organisations that have received sponsorship from the investor. A distinction is often made between 'active' and 'past' portfolios to distinguish which organisations the investor is currently involved with. However, all portfolio organisations are usually included in the greater network of the investor.

Portfolio manager (also known as investment manager)

Someone that is given the responsibility of tracking the performance of and maintaining communications with the various enterprises and/or initiatives within the investor's portfolio.

Pre-investment stage

The period during which the investor examines the operations and leadership of the project or organisation with a view to making an investment. This might include a detailed review of the financials or operations, or reference checks for organisational leaders. The term **due diligence** is also used, which has a legal definition as a measure of prudence. In other words, the investor is assessing whether they are likely to get what they think they are paying for.

Private equity

Ownership of a firm which is not publicly traded and which usually involves a hands-on approach and a long-term commitment from the investors.

Profit and loss statement (also known as income and expenditure account)

A financial statement that shows an enterprise's revenue and costs over a given period of time and, therefore, the net profit or loss over that time. It is not a cash flow statement and will not tell you how much cash is in the business to pay bills.

Q

Quasi-equity

Quasi-equity is a financial instrument that aims to reflect some of the characteristics of shares (preference or ordinary); however, it is neither debt nor equity. It is usually structured as an investment whereby repayment is linked to the investee's financial performance (e.g. repayment is calculated as a percentage of the investee's future revenue streams). (See also Revenue participation agreements in the Glossary of financial instruments.)

R

Regulatory sandbox

See **sandbox** below. It is also referred to in the context of **regtech**, the regulatory shaping of fintech.

Responsible investing (ESG investing)

Differentiated from impact investing in that it tends to screen portfolios to remove negative impacts. (See also **Impact investing**.)

Return on investment (ROI)

The profit or loss resulting from an investment. This is usually expressed as an annual percentage return. (See also Social return on investment.)

S

Sandbox

A term used in software development to describe a testing environment that isolates untested code changes and outright experimentation from the operating environment. The Financial Conduct Authority in the UK and a few other regulatory bodies have introduced sandboxes to allow fintech applications to be tested and commented upon before going live or gaining regulatory and compliance approval, thereby lowering the cost of market entry.

Regulatory technology (Regtech) was first envisioned by Andy Haldane of the Bank of England in a speech in 2014⁽²¹⁶⁾ and uses information technology to enhance regulatory processes. Its objective is to provide higher levels of quality at a lower cost and with greater transparency. To date, the focus of regtech has been on the digitalisation of manual reporting and compliance processes. The testing of these and other ideas are carried out within regulatory sandboxes. In 2018, these were extended to embrace green finance and socially inclusive financial instruments.

216 Haldane (2014).

Scaling up

The processes of developing, growing and multiplying the activities of an enterprise to expand its social reach and increase its social impact. Scaling up is often organised through replication or adaptation strategies which include strategic diversification (e.g. new products/services, target groups or locations), partnerships (e.g. networks, branding, licensing, social franchise or joint venture) and the dissemination of knowledge and know-how (open source).

Seed financing

Money used for the initial investment in a start-up company, project, proof of concept or initial product development.

Senior debt

The money invested in an enterprise that has the first claim for repayment. It is usually represented by security in the form of a first charge over assets of the company. In any repayment or liquidation, the lenders – starting with the senior debt – have priority over the equity investors.

Shareholders’ agreement

A legal document agreed by all shareholders specifying what the shareholders are and are not allowed to do with regard to their share rights and the selling of shares. In a social enterprise, this is also a place for the enterprise to state its mission and for each shareholder to state the purpose of their investment and the outcomes they expect to see. This agreement can be referred to if there is any mission drift.

Short-term investment

An investment made over a 1-year period or less, or an investment that matures in 1 year or less. (See also **Long-term investment**.)

Social capital market (also known as social investment market)

A financial market dedicated to social investment that aims to systemise and facilitate social capital allocation.

Social cooperative

Social cooperatives are cooperatives whose primary mission is not to generate benefit for their members, but societal impact. Whereas social cooperatives initially focused on the provision of services of general interest or in the reintegration, through work, of disadvantaged and marginalised workers (e.g. the disabled, long-term unemployed, former detainees or addicts), they have broadened their scope recently and now engage in the delivery of environmental, energy, educational, cultural and social services.

Social cooperatives are only legally defined in a few countries, such as Italy, Poland, France (SCIC) and Greece.

Social economy

The term derives from the French *économie sociale*, first recorded around 1900; however, the first Law of Social Economy (Law 5/2011) in Europe was not approved until early 2011 in Spain. At the European level, in 1989, the Delors Commission established a Social Economy Unit drawing predominantly on the French concept. In official texts however, social economy morphed into the term ‘cooperatives, mutuals, associations and foundations’. Today, social economy refers to the broad field of organisations whose major goal is to serve members of the community rather than to seek profit. Social economy organisations cover a wide range of social missions (from protecting the environment to promoting financial inclusion), and take on a variety of organisational and legal forms (including mutual benefit organisations such as co-operatives and mutual societies, public benefit organisations such as charities and philanthropic foundations, citizens organisations such as self-help groups and community-based organisations, social enterprises and social cooperatives, and solidarity finance schemes). The strategy, organisation, procedures and practices of social economy organisations are guided by the principles and practices of cooperation, solidarity, ethics, self-management, transparency, accountability and active citizenship. These are enshrined in their statute or Articles of Association to ensure:

- primacy of the mutual societal or environmental objective of achieving social impact over capital interests through the way they organise their activities or through the people that they employ;
- inclusive (democratic or participatory) governance structures and procedures to safeguard their social mission and to control the actual pursuit of the organisation's goals;
- voluntary and open membership and democratic control (for organisations borne by members);
- autonomous management and independence from public authorities;
- reinvestment of most of the profits/surpluses in pursuit of sustainable development objectives, services of interest to members or the general interest.

Around the world, social economy can mean subtly different things depending on which legal form predominates. In 2018, the UN released a statistical guidance document on what it refers to as the ‘TSE Sector’ ⁽²¹⁷⁾.

Social enterprise

See the Introductory chapter.

Social entrepreneur

Defined by the Schwab Foundation for Social Entrepreneurship as ‘a different kind of social leader who: identifies and applies practical solutions to social problems by combining innovation, resourcefulness and opportunity [and] innovates by finding a new product, a new service, or a new approach to a social problem’ Social entrepreneurs may be sole traders or work in environments that are not necessarily recognisable as social enterprises.

217 Newhouse (2018).

Social finance

Social finance ‘may be understood as a broad area wherein various forms of capital are structured in ways that consider and value both financial performance and social value creation’ ⁽²¹⁸⁾.

It covers all financial instruments that:

- pursue an accountable social, cultural or environmental purpose;
- are autonomous of the state;
- have the mission of the investee as the principal beneficiary of any investment;
- are transparent about assessing, measuring and reporting the social impact they seek to create;
- are structured to create financial value or organisational or community capacity over time, (e.g. by helping the investee invest in growth, acquire an asset, strengthen management, generate income and/or make savings, and by providing wider non-financial support);
- are inclusive ⁽²¹⁹⁾.

As a rule, social investment is defined as being at least nominally repayable ⁽²²⁰⁾. However, in trying to present the full picture and all opportunities for social enterprise finance, this publication includes grants, gifts, money given with/without condition to recognise their importance.

(See also the Introductory chapter.)

Social impact

The social benefit derived from the activities of a social purpose organisation. For our purposes, social impact includes environmental and/or cultural as well as social impact. (See also **Social purpose organisation.**)

Social impact bond (SIB)

See Glossary of financial instruments.

Social indicators

KPIs specifically adapted to measuring the performance of social purpose organisations. (See also Balanced scorecard, Social impact and Social return on investment.)

Social investment

See also **Social finance** and the Introductory chapter.

218 Emerson et al. (2007).
219 Alternative Commission on Social Investment (2015).
220 Alternative Commission on Social Investment (2015).

Social Investor

A social investor invests for the primary purpose of supporting a vision of a better world or, within that, in an organisation that is enabled to achieve positive social impact by virtue of his/her/its investment. While a social investor may seek market comparable returns where these are still beneficial to the investee, there are likely to be concessions in favour of the mission and the impact. To a social investor, some degree of financial return may be important but is not essential and there may be a risk of losing some or all of the capital sum too, but the social impact is the priority.

Social investment finance intermediary (SIFI)

An organisation that provides, facilitates or structures financial investments for social sector organisations and/or provides investment-focused business support to social sector organisations ⁽²²¹⁾. (See also CDFI.)

Social purpose organisation (SPO)

This term captures the entire spectrum of organisations whose primary purpose is to create social value (rather than shareholder value). The terminology for these different kinds of organisation varies enormously across countries and jurisdictions and is therefore far from precise. The term is used predominantly by EVPA in Europe, although it is also in widespread use in North America. The following types of organisation fall under the banner of SPO. (See also **Social impact** and **Third sector organisations.**)

- Charity, non-profit, not-for-profit, foundation, association and CLG (having no trading activities, or where trading is of marginal importance).
- Social enterprise (having trading as a significant or exclusive part of their operations). Some do not make any financial returns to investors (or cap returns) but reinvest surpluses into the organisation. Even within the term social enterprise, there are several different models.
- Socially driven business: profit-distributing businesses but with clear and stated social objectives.

Socially responsible investment (SRI)

Also known as sustainable, socially conscious, ‘green’ or ethical investing, this term defines any investment strategy seeking both financial return and social good. In its broadest usage, SRI also refers to proactive practices, such as impact investing, shareholder advocacy and community investing. SRI encourages corporate practices that promote environmental stewardship, consumer protection, human rights and diversity. It can also represent the avoidance of investing in industries or products that can be socially harmful, including alcohol, tobacco, gambling, pornography, weapons and/or the military. The term dates back to the Quakers, who, in 1758, prohibited members from participating in the slave trade.

221 Big Society Capital (n.d.b).

Social return on investment (SROI)

The SROI concept, essentially a cost–benefit analysis, is used by charities, donors and third sector organisations to rate the results of their endeavours with firm evidence of impact and created value. The idea of SROI was pioneered in the 1990s by a US venture fund called The Roberts Enterprise Development Fund and has since been taken up elsewhere. In Europe, the professional association of social impact analysts, which also promotes the SROI concept, is Social Value International.

Social venture capital

Social venture capital is an approach to tackling social problems through investment to support the creation and expansion of commercially sustainable enterprises to maximise social and financial returns. In developing countries, this approach is used to create jobs and empower the poor.

Solidarity finance

Centres on human beings and their social ties, and serves as a tool for human and social development. The association Finansol states that ‘solidarity finance encompasses all financial opportunities that allow individuals to invest directly or indirectly in a project or social enterprise with a strong social and/or environmental objective’ ⁽²²²⁾.

Spin-outs

In the context of social finance, spin-outs are companies set up by experts who want to take a solution developed within the public sector, such as a university or health service, and scale it independently. This can help counter the shrinkage of the public sector that is occurring in many countries. Some spin-outs are done for cosmetic reasons, specifically, to move the budget out of the public body.

Standby facility

A standby facility can provide useful insurance for an enterprise if it is not certain about the timing of receipts in its cash flow or if it may have to allow for contingencies in its spending. A standby amount of money is agreed by the bank, which charges a commitment fee on the unused part (usually in advance to maximise income), as well as interest on drawings. At the end of the agreed term, the amount drawn has to be repaid in full and the undrawn balance is cancelled.

Sustainable Development Goals (SDGs)

A collection of 17 global goals set by the UN General Assembly in 2015 as part of the 2030 Agenda. They grew out of the Millennium Development Goals. The SDGs are a universal call to action to end poverty, protect the planet and ensure that all people enjoy peace and prosperity ⁽²²³⁾. An increasing number of impact investment funds target enterprises working to achieve the SDGs.

222 Finansol (2018a).
223 United Nations (n.d.b).

Sweat equity

The ownership interest or increase in value created as a direct result of hard work by the owner(s), as opposed to financial equity. It is the preferred mode of building equity for cash-strapped entrepreneurs in start-ups. Determining how to value sweat equity is key when negotiating investment.



Techfin

Unlike fintech, which starts with finance and uses technology to do it faster and cheaper, techfin is technology that is used to provide financial services: it starts with technology and then considers how to use it to trade or exchange value. This makes it a very different view of the world to fintech. Techfin is about creating the financial system for the future, not a future bank. An example is Ant Financial in China ⁽²²⁴⁾. Its aim is inclusion. Starting as an offshoot of Alibaba in 2003, Ant Financial’s ambition is to reach 2 billion consumers by 2025 founded on a belief of making better people, better society and a better planet.

Term sheet

A summary of the proposed major terms and conditions of an investment that is agreed by all parties before the investment is made. It is not legally binding, but usually covers things such as the type of investment to be made, any board representation or other governance requests, impact measurement approach and mission, as well as the timeline and process for completing the investment. The shareholders’ agreement is drafted from this.

Third sector, third sector organisation

A term used to describe the range of organisations that are neither public nor private sector. Third sector organisations are also known as NGOs, non-profit organisations, civil society organisations or SPOs. They include charities, voluntary groups, some social enterprises, mutuals and cooperatives. Third sector organisations are generally independent of government, are value driven and reinvest surpluses in pursuit of their goals. They can take many legal forms.

In order to generate solid data on the third sector, the *UN’s Satellite Account on Non-profit and Related Institutions and Volunteer Work* handbook provides comprehensive methodological guidance on its measurement ⁽²²⁵⁾. It covers all entities and activities that exhibit three key attributes:

- They are private, i.e. not controlled by the state.
- They are primarily oriented to public benefit purposes, rather than the pursuit of private profit.
- They embody a significant element of free choice.

224 Skinner (2017, 2018).
225 United Nations (2018).

Triple bottom line

Coined by John Elkington, triple bottom line refers to the three prongs of economic, social and environmental accountability ⁽²²⁶⁾. While businesses of the past only had to be accountable for their economic performance, today's enterprises are increasingly pressed to demonstrate concern for three bottom lines: those of finance, people/communities and the environment ⁽²²⁷⁾.

Triple-bottom-line investment

Triple-bottom-line investment is the simultaneous pursuit of beneficial returns along three dimensions: economic, social and environmental. (See also **Blended value**.)

U

Unbundled start-up

Traditionally, corporations have sought to integrate services and achieve economies of scale. However, technology is turning this thinking on its head. It is now recognised that one size does not fit all customers. The internet has fuelled the desire for immediate and customisable service. From banking to healthcare and other public services, unbundled start-ups seek to provide a particularly better service for one aspect of a business, but not all of them. If they provide customers with what they want, people will use these and the integrated value chain of a big supplier will diminish.

V

Valley of death (also known as the death valley curve)

The 'valley of death' is a phrase that has migrated from venture capital to refer to the period of time spanning from when a start-up receives an initial capital contribution to when it begins to generate revenues. During this period, additional financing is often scarce, leaving the enterprise vulnerable to cash flow requirements. The term refers to the high probability that a start-up will die before a steady stream of revenue is established. The longer a start-up burns through its cash, the higher the likelihood that it may not endure.

226 Elkington (1997).

227 Interestingly, Elkington has recently started to reconsider his own term. See Elkington (2018).

Values-based bank

Banks and banking cooperatives with a shared mission to use finance to deliver sustainable economic, social and environmental development. The Global Alliance for Banking on Values (GABV) comprises 54 financial institutions (as at July 2018) operating in countries across Asia, Africa, Australia, Latin America, North America and Europe, serving 50 million customers, holding up to USD 163.4 billion of combined assets under management and powered by a network of almost 60 000 co-workers ⁽²²⁸⁾.

Venture philanthropist

A person engaged in venture philanthropy, either as an individual or in conjunction with a venture philanthropy organisation. (See also **Venture philanthropy**.)

Venture philanthropy

Works to build stronger social organisations by providing them with both financial and non-financial support in order to increase their social impact. The organisations supported may be charities, social enterprises or socially driven commercial businesses, with the precise organisational form subject to country-specific legal and cultural norms. As venture philanthropy spreads globally, specific practices may be adapted to local conditions, yet it maintains a set of widely accepted, key characteristics. These are:

- **high engagement:** hands-on relationships between the SPO management and the venture philanthropists;
- **involvement of networks:** enabling access to networks that provide various and often complementary skill sets and resources to investees;
- **tailored financing:** using a range of financing mechanisms tailored to the needs of the supported organisations;
- **multi-year support:** supporting a limited number of organisations for 3-5 years, then exiting when organisations are financially or operationally sustainable;
- **non-financial support:** providing value-added services, such as strategic planning, to strengthen management;
- **organisational capacity building:** building the operational capacity of the portfolio organisations by funding core operating costs rather than individual projects;
- **performance measurement:** placing emphasis on good business planning, measurable outcomes, achievement of milestones and financial accountability and transparency.

228 Global Alliance for Banking on Values (2019).

Voluntary income

Defined in UK accounting practice (UK GAAP) as covering all income that is not earned from trading or contracts. It includes donations, grants and other monies voluntarily given, such as legacies. It is an important resource for many third sector organisations.



Warrants

Warrants and options are similar in that they both give the holder the right to purchase securities, usually equity, from the issuer at a specific price within an agreed time frame. They are often included as a 'sweetener' in a new debt issue to entice investors.

Working capital

All organisations experience delays between spending and receiving money. These are known as timing differences and the finance required to manage or bridge these differences is known as working capital.

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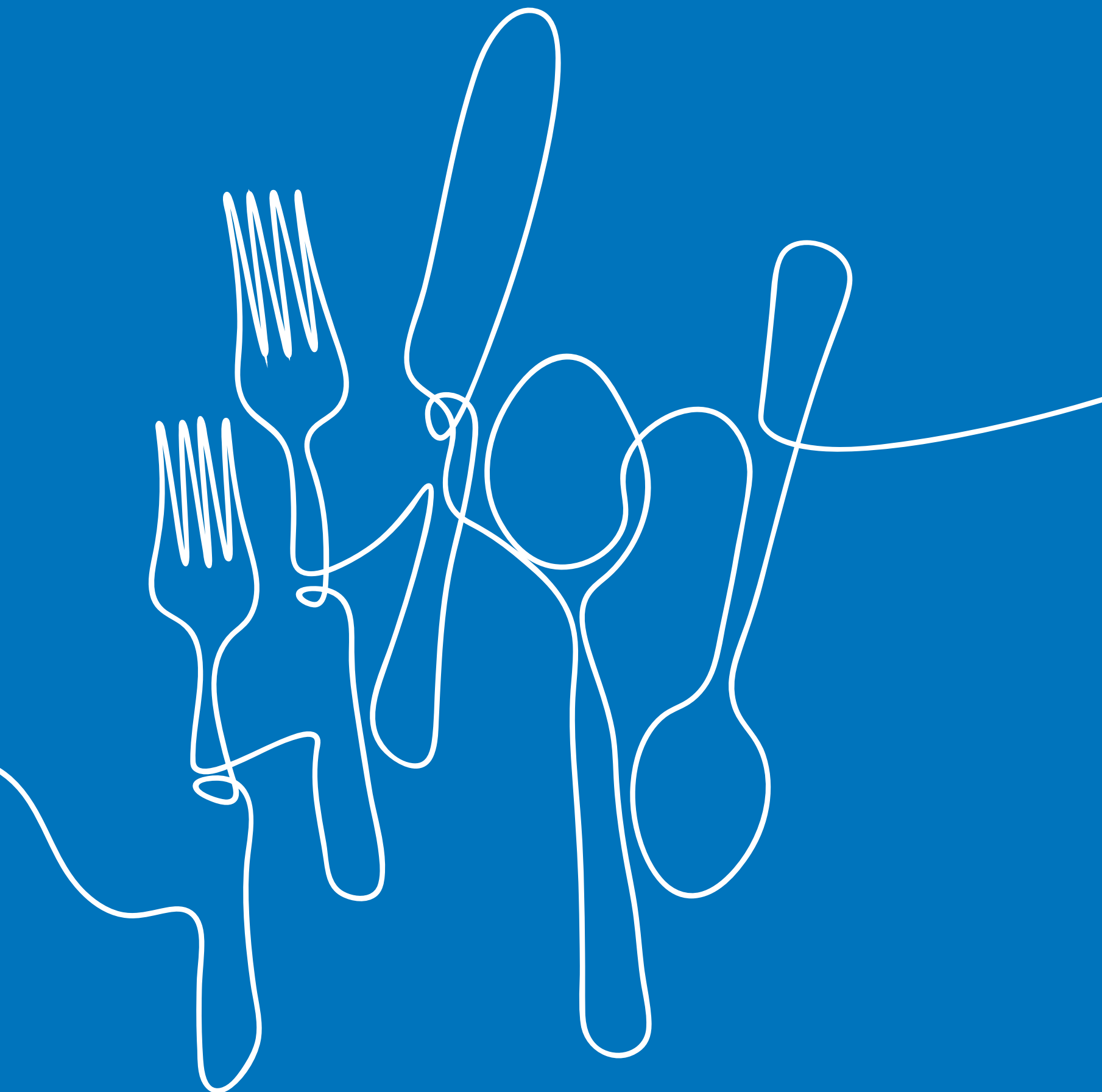
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