European Commission

A recipe book for **social finance**

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

Social Europe

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

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European Commission
Directorate-General
for Employment, Social Affairs and Inclusion
Unit E.1

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Introduction

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 business 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 not merely 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; we see it 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 businesses of the future.

Social finance markets have been developing dynamically in many European countries, resulting in innovation and experimentation. Ingredients from third sector finance, 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 to see the birth of the first loan fund or impact-oriented investment; others 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 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 by their customers.

B. Who should read this guide?

We hope the 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 the European or global levels. Perhaps it is a good idea to cook a dish for two before inviting the entire neighbourhood, so 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.

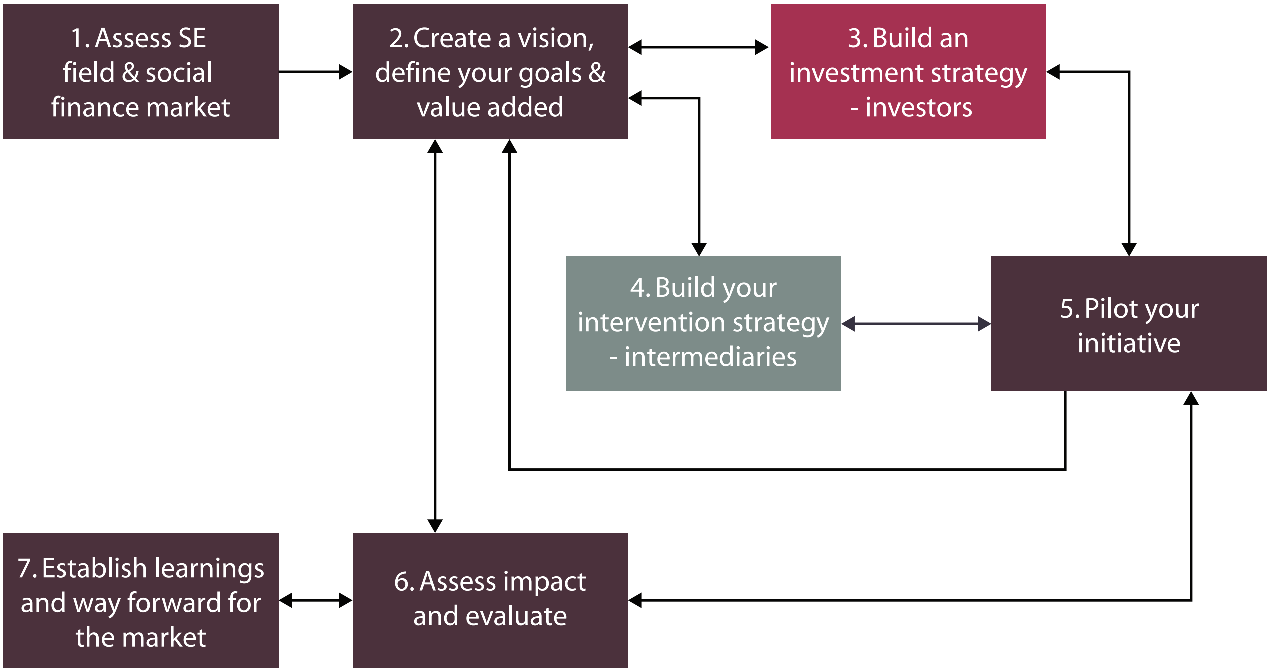
This guide is intended for practitioners: financiers, social finance intermediaries, market builders, social enterprise support organisations, social enterprises and interested individuals. It is not a policy paper. We consider the policy and regulatory environment as a given, except if, as in some cases, it is the enabling environment and regulatory framework itself that some brave stakeholders are trying to develop. We recommend that policymakers and public sector stakeholders read the guide and develop their understanding of the perspectives and considerations of other actors in the social investment field.

C. How should this guide be used?

As can be seen in Figure 1 overleaf, this guide is divided into seven chapters, which follow the thinking and decision-making process that investors or social finance intermediaries can follow in designing and piloting their initiative. It guides you through the process, pointing out key considerations and possible pitfalls, illustrated by

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

Figure 1. Logic of this guide



case studies and examples where possible. The guide does not provide detailed descriptions or definitions of financial instruments or regulations, but provides a list of key concepts in the Glossaries and Annexes. In addition, you will find references to tools and good practice that have been developed by others, plus existing literature, should you wish to dig further. Examples, checklists and key questions at the end of each chapter should help you to summarize the learning and move to the next step.

D. What's inside this guide?

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 to create the investor's or intermediary's vision and define the goals and specific value added, which are described in Chapter 2. Following this, we ask you 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 the 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: how to develop the supply and demand side 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. Finally, in Chapter 7, we recap lessons learnt and discuss key conclusions and possible ways to move forward.

E. Sources for this guide

In compiling the guide, we have relied on research, reports and case studies that are available in the public domain, as well as our 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. 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.[2]

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 the 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'. Social finance is not about the financing of social, cultural or environmental initiatives, 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. It 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.

Before we continue, we should define the key terms we use throughout. Definitions and explanations of other terms can be found in the glossaries.

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.[3]

Social finance or social investment should have the following characteristics:

- Is at least nominally repayable
- Pursues an accountable social, cultural or environmental purpose
- Is autonomous of the state
- Has the mission of the investee as the principle 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.[4]

Social finance ecosystem

The *social investment 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*, we will be focusing on the marketplace, where demand and supply meet (i.e. transactions between investors, intermediaries and social enterprises).

Figure 2[5] provides an overview of social investment and how finance and support are deployed. In summary, the ecosystem is made up of a growing number of **investors** who seek to use their capital to meet economic, social, cultural and environmental

2 A description of the Preparatory Action can be found in Annex 1.
3 EaSI regulation COM(2011)609 final; see 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
4 Alternative Commission on Social Investment (2015)
5 Cabinet Office (UK) (2011)

objectives. The landscape is characterised by great variety in motivation; target markets, which reach beyond social enterprises and third sector organisations; the desired blend of 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 **intermediaries** have emerged to connect investors with investees and target communities. Intermediaries bring together the resources, finance, skills, spaces, systems, market development and engagement to do deals and provide services.

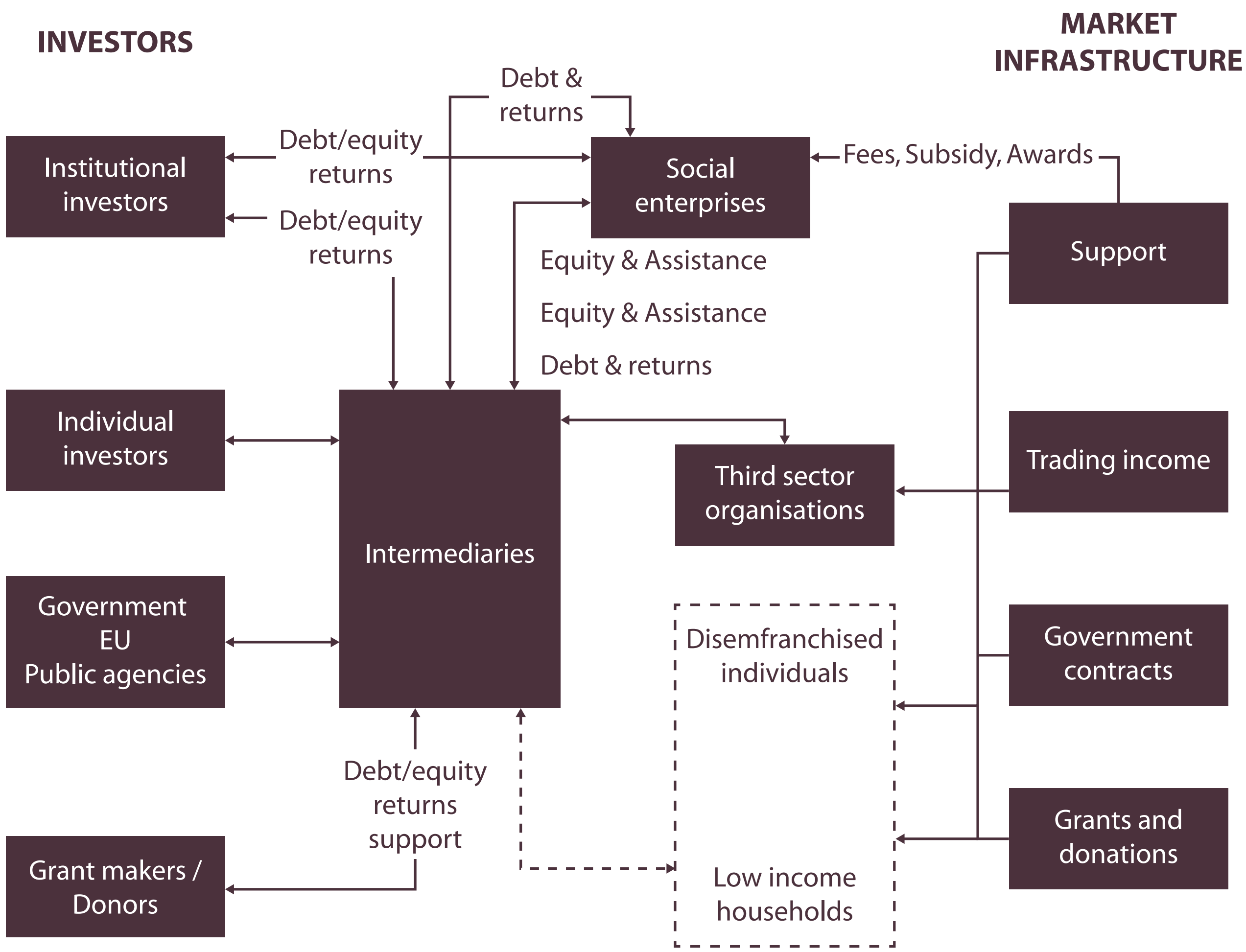
Social enterprises that represent many forms and stages of development are unable to access finance at certain stages in their lifecycle. **Third sector organisations** include two traditions: one of mutual self-interest, exemplified by cooperatives and mutuals, and another of charity, where people and organisations respond directly to social needs. Together with social enterprises they comprise much of what is also known as the 'social economy'.

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 do financial returns.

The social investment ecosystem is like other ecosystems. It is not static; it is dynamic and continually adapting to change. Through financial technology disruption, this pace of change is likely to accelerate.

Figure 2. Social investment ecosystem

Source: Adapted from Henry and Craig (2013, 13)



Chapter 1: Assess the social enterprise field and social finance market

The demand and supply sides; basic ingredients

1. Assess the SE field and social investment market

a. Demand: social enterprises
- Field of activity, legal form
- Stages of development
- Purpose of finance

b. Supply: social investment
- Difference to mainstream investment
- Appropriateness
- Social investors
- Forms of investment

c. Other key ingredients
- Enabling environment
- Viable business models
- Non-financial support
- Other stakeholders

d. Assessment of market
- Gaps
- Barriers and opportunities
- Methods

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. As you would do before introducing a new recipe or product, you would like to know in advance 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. 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 which 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 Eco-system in Europe*.[6] It outlines the main aspects of social enterprises in the 28 EU member states and Switzerland, and it also offers an overview of social enterprise ecosystems across countries.

The assessment step may be very quick or fairly lengthy, but it is always worth the investment of time and a small amount of resources. There are a number of benefits that a market assessment can bring. You can:

- Gather information about regulations and culture 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 so far. Could you fill them?
- Find potential future partners
- Decide whether there is space and need for you to launch your initiative

6 European Commission (2015a)

Before we set out on our 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 is shared.
2. **Social investment is a source of income for social enterprises.**
   It isn't. It has to be repaid.
3. **Social Investment is new, untested and risky.**
   It has been around on and off since the Monte di Pieta of 15th century Italy, so as long as banking, really.
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.**
   It isn't, if the match with the product and provider are appropriate.
6. **Social investment is complex and difficult to understand.**
   Not all deals are social impact bonds 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. Almost €3bn was raised in Europe in 2014 across all market forms.
8. **Social investment only happens in developed financial markets.**
   No, it happens across Europe (and the world).
9. **There aren't enough deals to invest in.**
   For the 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?

1.1. What do social enterprises need finance for? The demand side

In this guide we will be using the EaSI definition, although we are aware that in some EU countries the public understanding of the term social enterprise may vary.[7]

1.1.1. 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, 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 child care; employment and training services; social housing; 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 waste or facilitating renewable energy
- Practising solidarity with developing countries (such as promoting fair trade)[8]

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 and financial services. Some countries limit the recognition of social enterprises to certain fields by defining a legal form which is only permitted to act in certain areas, for example, those deemed of public benefit or work integration social enterprises (WISEs).

7 The above-referenced mapping study provides further information about these different understandings in its Section 2.2.
8 European Commission (2015)

Figure 3. Social enterprise lifecycle

To sustain their mission, social enterprises need to become viable businesses. As such, they have more commercial and investment-minded financing options open to them than other third sector organisations. They use different forms and amounts of financing depending on their field of activity, stage of maturity and form of governance. The types of finance are covered in more detail in Chapter 3. It is clear, however, from many surveys (including that carried out by Social Investment Scotland within the pilot projects, see example in section 1.4.3), that although social finance and commercial finance for social enterprise has been available for some years, many social enterprises remain unaware of what is available or find it's not what they need. In research undertaken by the Charities Aid Foundation in 2014,[9] only 3% of respondents had experience of borrowing and only 7% had plans to do so. Similarly, Lyon and Baldock[10] analysed Social EnterpriseUK data and concluded that 65% of social enterprises are not interested in repayable finance and only 15% are seeking loan finance, with most borrowing from mainstream banks. Only 3.6% of all social enterprises are approaching social investors.

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.

There is a wide range of legal forms that social enterprises can take across the EU member states. These are referred to in the glossaries to this guide. The legal form may be a decisive factor in the ability of the social enterprise to access certain forms of social finance.

1.1.2. Stage of development of social enterprises

In general, social enterprises need funding at all stages of their development, from blueprint to scale. Philanthropy and money from family and friends can get an enterprise through the blueprint stage and allow it to validate its model, but it will not be enough to fund the enterprise going forward. Although many investors care about social impact,

9 Charities Aid Foundation (2014)
10 Lyon and Baldock (2014)

Example: Impact in Motion mapping of 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. They found the following purposes that social ventures in Germany seek finance for through their lifecycle[11] research and development, capacity building, real estate development, working capital financing, business expansion, knowledge sharing and public education, as well as 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 that Impact in Motion identified served as a key input to their choice of vehicle and design of investment strategy.

few are impact first investors and few are thus likely to have a primary goal to generate a (significant) return on their investment.

Many social enterprises and, by association, the funds, investors and intermediaries who serve them work with marginalised or excluded (from the mainstream) communities. They can face multiple challenges: 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.

1.1.3. Purpose of finance

Social enterprises need financing 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 (purchase of property or equipment) or to build reserves or growth capital (growth capital could include the expansion of existing services, 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. Grant makers (public or private) are often reluctant to fund certain things; for example, EU grants 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 the 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.

1.2. Characteristics of social investment: The supply side

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

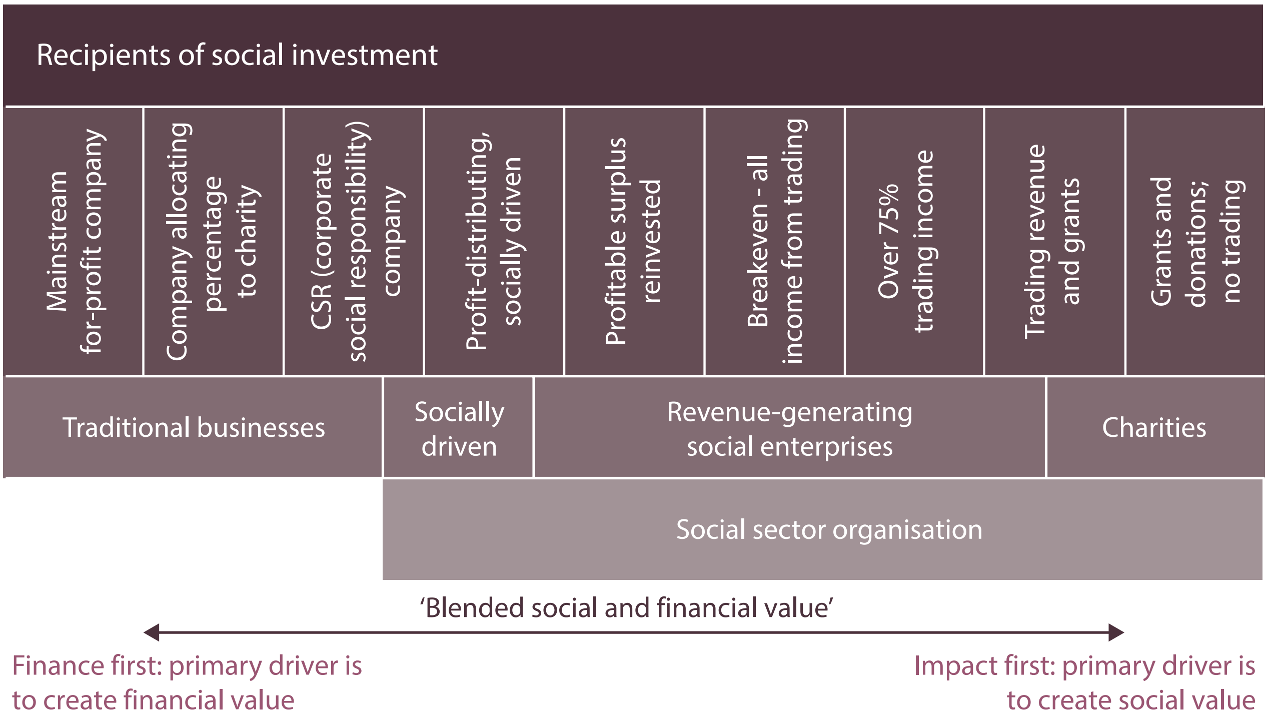
Classical mainstream investment can be defined as putting your money to work in order to increase (maximise) your earning potential – the act of committing capital or money to a project or business with the expectation of obtaining income or profit. The focus is on private investor returns. It would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

As we can see from the above, social investment is where the focus of the investment (financial and non-financial) is on the fuller social, environmental, cultural and economic benefits of an initiative, on the organisation's work and on the health of society as a whole. As Figure 4 below shows, this gives rise to a spectrum of expected returns, from a modest

11 Global Learning Exchange (2015)

Figure 4. Investment spectrum

Source: Charity Bank (2015), adapted from European Venture Philanthropy Association (2015)



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. 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'.

Social investment is not just about finance and intermediary support. It is also about finance that attracts citizens of 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.

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

Social enterprises are not natural borrowers; however, current circumstances are making them think differently. In the UK, voluntary income to the third sector has fallen by nearly €3bn since the 2007–2008 crash, while grants from government halved in the same period. This growing scarcity of grant funding has forced many to look for alternative ways to finance their activities, while others 'jumped before they were pushed' and looked for new ways to kick start new operational models. But some were mainly – sometimes only – interested in obtaining money on the most affordable and least restrictive terms possible. This was unlikely to be available from the local commercial bank unless no other source existed. 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 banks) are large providers of finance to social enterprises who have long understood that banking is a combination of both responsibility for society and of making a reasonable profit to generate fair livelihoods. Nevertheless, they have a primary obligation to protect the savings of their depositors. They do not have the flexible risk appetite that would

Example: The social investment landscape in Spain

Cooperative Mondragon, founded in 1943, is the largest cooperative group in the world. Along with many other cooperatives, it is financed by Caja Laboral Popular, formed in 1959 as a cooperative credit institution. Today, Mondragon is made up of 260 businesses and cooperatives and has a worldwide presence. Caja Laboral is currently partnering with the European Investment Fund, the Government of the Basque Region and the Employment Service to offer unsecured loans up to €25,000 for a new generation of enterprises through its Plan de Emprendizaje de Gaztenpresa, Atrevete a Atreverte. 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 Spanish NGO Fiare. At the other end of the spectrum, Creas is a foundation which provides finance and the expertise of their professionals and networks through the social venture capital funds Creas Inicia and Creas Desarrolla. It seeks both economic returns and positive social impact, and it works through the social enterprise networks, Ship2B, socialnest and UnLtd Spain to develop deal flow.

allow them to provide higher-risk social finance. Foundations could, 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 philanthropy, 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. If we assume 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 in 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. 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 (less than €250,000; often less than €50,000),[12] 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 do not syndicate investments among themselves at the scale that commercial banks do.

1.2.3. 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. Social investment offers a more empathetic approach than the mainstream.

12 In the post-2008 world, there is an estimated €3–4 trillion shortfall worldwide in the funding of micro, small and medium enterprises, including social enterprises. Source: World Bank (2015)

Example: Social investors in France

There is a wide spectrum and a large number of different categories of social investors 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 Garrigue, Ides or Sifa ; nonprofit lenders, such as France Active and L'Adie; investment clubs, such as Cigales and Clefes; financing companies, such as Caisse Solidaire du Nord pas de Calais, France Active Garantie, and Banque la Nef, as well as credit unions and mutuals; land organisations, such as Terre de Liens and Habitat & Humanisme; and overseas investments through nonprofits, such as SIDI. Indirect investment in social enterprises is the most frequently used route of social investment. According to a 2012 survey, the average investment per enterprise is €250,000, with an average duration of five years and targeted return of 2–7%. Investment clubs see themselves as start-up engines, providing around €2,000 per financing deal, while other investee enterprises may graduate up to Banque la Nef, where loans may be more than €1m.[13]

Social investors range from angel investors to funders of large-scale initiatives. They could be venture philanthropy funds, charitable foundations, or loans or investment funds. They 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.

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

1.2.4. Forms of investment and their appropriateness: Equity, 'patient' capital and debt

A 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 balancing issues between mission and mainstream equity.

Social investment can be made in the form of debt or equity models, or in the form of hybrid models incorporating both plus grants. Ignoring gifts and grants, debt instruments currently dominate. Guarantees are contingent liabilities which will only become debt, or equity if called. For the purpose of market assessment, Table 1 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 which have been proposed – can be found in the Glossary of financial instruments found at the end of this guide, together with our (subjective) ranking of their feasibility and relevance.

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, who often provide low- or zero-interest loans with documentation rarely extending beyond a page (if that).

13 Survey by OpinionWay in 2012, quoted in Guezennec and Malochet (2013)

Table 1. Forms of investment

Form of investment	Key features
Secured loan	• Loan given against security (which can be repossessed if failure to repay); security may be tangible (bricks and mortar) or intangible (cash flow, guarantees, 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 £1m • 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 because of governance and structure limitations • An option may be 'quasi-equity', where investors receive variable repayments often linked to revenue (this is looked at in more detail in Chapter 3) • Investment may come with add-on support
Guarantees	• Contingent risk, so no money is provided up front; you can keep your money invested at interest, unless required to deposit with the lender (cash-backed) • Can take many forms: performance, advance payment, usually 50–80% of risk • On demand or conditional

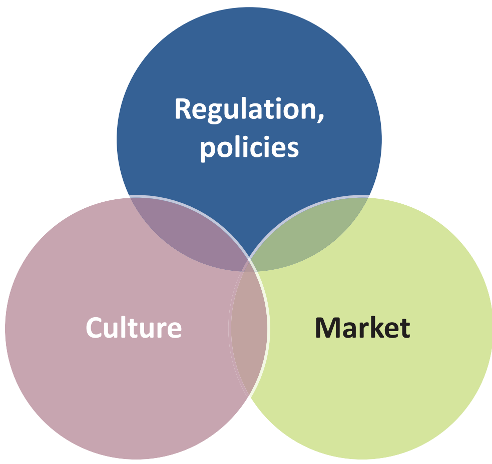
Source: Adapted from New Philanthropy Capital (2015)

1.3. Other key ingredients of the social investment ecosystem

1.3.1. Enabling environment

The enabling environment for social enterprise development and finance 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! Nonetheless, it is worthwhile to think about three main spheres of the environment.

Figure 5. 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. Some countries have introduced special legal forms for social enterprise (e.g. 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 may be in place, which can directly influence the way the field develops. An important part of such strategy may be the allocation of specific funding (from EU or national sources) towards 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, so social enterprises that were working in these fields lost their beneficiaries and their revenues. The removal of tax subsidies for renewable energy in the UK is expected to have a 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. European Social Entrepreneurship Fund, EuSEF[14]), 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. France and the UK).

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 securing sustainable revenue-generating models? Is there targeted regulation that encourages certain customer behaviours, such as the *Social Value Act*[15] 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.

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/environmental message, and to the existence of entrepreneurial, innovative thinking. Experience 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 side, as a lack of such culture may impede the development of potentially beneficial joint delivery or co-investment models.

1.3.2. Viable business model

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 important barriers to the development of social enterprises and their attractiveness to funders is the lack of convincing business plans and sustainable business models. Social enterprises are often working 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. The majority of social enterprises also lack the business planning and implementation skills, especially in the early stages; hence the importance of capacity-building organisations, consultants and incubators that can assist 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.

14 The EuSEF regulation, which entered into force in July 2013, created a pan-EU marketing passport, with uniform criteria for all fund managers investing in social sector organisations (defined in the regulation as Social Undertakings) through 'funds' that meet the EuSEF criteria. Eligible funds need to have a measureable and positive social impact as their explicit focus. The regulation also requires EuSEF managers to put in place procedures for monitoring and measuring the positive social impacts that are to be achieved by their investments. Additionally, the EuSEF label may only be used by fund managers that are fully transparent as to their investment policy and investment targets. Source: EVPA (n.d.b)

15 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: Public Services Act (2012); Cabinet Office (UK) (2015)

Example: Non-financial support to investors?

It must also 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 in making social investments. The UK's Charity Bank and other values-based banks offer '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 process 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 an issue, namely, what is a fair return for such investment and to what extent is it spread across financial and non-financial return?

1.3.3. Non-financial support

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, non-financial support rather than generic small- to medium-sized enterprise consultancy.

Very few charities and start-up social enterprises 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 business planning, governance and development activities in order to realise the full potential of their business idea.

The typical menu of non-financial services consists of:

- Business strategy support
- Access to networks and contacts
- Specific resources and services

Apart from support organisations, investors themselves often provide non-financial support to the social enterprises they have invested in. This often has 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 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.

1.3.4. 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, who play different roles and are positioned in 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 their numbers; 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 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 giving visibility to new initiatives. The public sector can also appear as a purchaser or customer of social enterprise services, thereby contributing to a sustainable revenue-generation model, which in turn attracts social investment. 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

Table 2. Stakeholder groups on the supply and demand sides

DEMAND SIDE	Those that demand finance and support services
Social enterprises/investees	• Social enterprises • Charities
Beneficiaries/customers/members	
SUPPLY SIDE	**Those that supply finance and support services**
Public sector	• Government ministries, (development) agencies • Local authorities, commissioners • EU funds–managing authorities
Academia	• Researchers • Trainers, professors
Financiers	• Private trusts and foundations • Individuals (including donors) • Corporations and their foundations • Values-based banks • Venture philanthropy, social investment funds • Commercial banks • Savings and cooperative banks • Umbrella organisations of the above
Expertise	• Intermediaries • Support organisations • Consultants

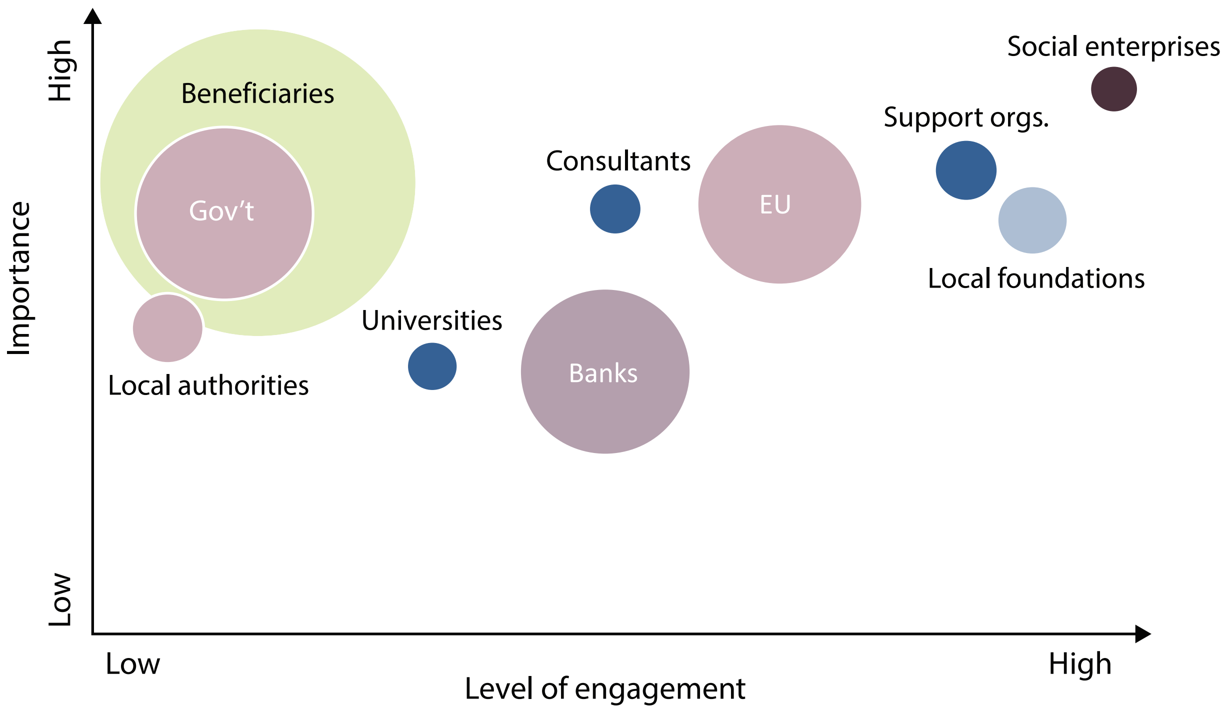
public sector contracts, and thus the growth of the social enterprises has been significantly limited (for example, as is the case in some Central European countries).

The most common stakeholder groups on the supply and demand sides of the market are presented in Table 2 above.[16]

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 and how? If you are looking at a nascent market, the role of 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 resources allocated are insignificant, market actors can struggle and development may be very slow. Governments in other contexts may be *too* active, for example, by squeezing out private investors by dominating the funding market, or by nationalising 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, which are unable to come up with promising business models.

16 A more detailed explanation of finance providers will be provided in Chapter 3, while explanation of support organisations and intermediaries will follow in Chapter 4.

Figure 6. Stakeholder positioning in country A



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

The example below shows typical stakeholders in a hypothetical market positioned along the 'importance' and 'engagement' axes. The size of the bubble indicates resource availability (not necessarily resources used) of the various stakeholders.

1.4. Assessment of your social finance market

1.4.1. Where are the gaps?

The assessment of what already exists in the market should be highlighting the various gaps and opportunities. The gaps most likely to be highlighted fall into the following categories: 1) knowledge and skills gap; 2) financing gap; 3) regulation gap.

1. **Knowledge 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, 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. These gaps can be filled in many ways, which could lead to your possible solution or involvement in the market: 1) buying in the services of paid experts and support organisations to work with 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 the lack of sufficient funding available to meet market needs, the lack of certain types of financing products and favourable conditions, the lack of a specific financing/investment ranges or the lack of a secondary market. A typical problem encountered by social finance markets is the existence of the 'death valley', i.e. lack of investments for the start-up or consolidating of enterprises. In Nonprofit Enterprise and Self-Sustainability Team's (NESsT) experience in Central Europe this is up to the €100,000 level; Impact in Motion in Germany found limited availability of capital in the €100,000–500,000 range, while the Impact Hub in Milan reported a

gap in transition finance between €100,000 and €200,000.

3. **Regulatory gap:** The regulatory gap usually means a missing piece of regulation, which can be either a showstopper 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. 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.

1.4.2. 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. Some of the most important barriers can be summarised as follows (it is important to be aware of these, as you may be just the investor who can do something about them!):

- Social enterprises are **perceived by investors as high risk**. They are often small, lack 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. 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 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.

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 ones are not met, and why? What are the biggest obstacles for social enterprises to become 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 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 the capacity for follow-on investment and/or a secondary market, leading to more liquidity and ability to exit an investment?

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 or the director of the Donors Forum (the membership organisation of private foundations)
   b) Outstanding and vocal individuals, that is, 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!

- **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. A lack of globally utilised impact measurement standards (except for a few initiatives, such as Impact Reporting and Investment Standards known as IRIS[17]) makes it difficult for investors to benchmark their investment against others, which in turn makes it hard to understand the full value of – and put a price on – social impact.
- **Market size** in many countries prevents social enterprises from appearing on the radar screen of investors. Small deal sizes and a small number of deals make this market unattractive to investors who wish to place significant amounts of funding.
- **Markets are fragile**. The price, ability to pay and social value generated are often out of sync, which makes the social enterprise business models unstable and unsustainable.

1.4.3. Methods of 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. Conferences, fairs and major events could be a good place to meet the major players and learn about trending discussions in the field. Going through secondary sources can be very useful for two reasons: 1) it can help increase your general understanding and identify unanswered questions and 2) it will help you to create a list of actors and stakeholders active in the space whom you might wish to contact in the future.

Once you have a general overview, you can use primary sources to dig deeper. Primary sources are typically people and organisations whose opinion and experience 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.

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

Example: Market assessment conducted by Social Investment Scotland

Social Investment Scotland (SIS) is a charity and social enterprise that provides loans to charities, social enterprises and community groups in Scotland. In developing a pilot project of 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 serve as a conduit for business planning support.'

Market assessment was a crucial first step in the SIS project, because further elements of the programme would be built on this foundation. SIS 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 Big Lottery, which had identified about 3,500 social enterprise organisations in Scotland. In addition to this, the SIS 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, SIS 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. 'SIS has also provided the databases created from this survey to key bodies such as Highlands and Islands Enterprise and Scottish Government in order for them to better understand the makeup of the sector.'[18]

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; selecting who you talk to can therefore be crucial.

1.4.4. Conclusion of the assessment

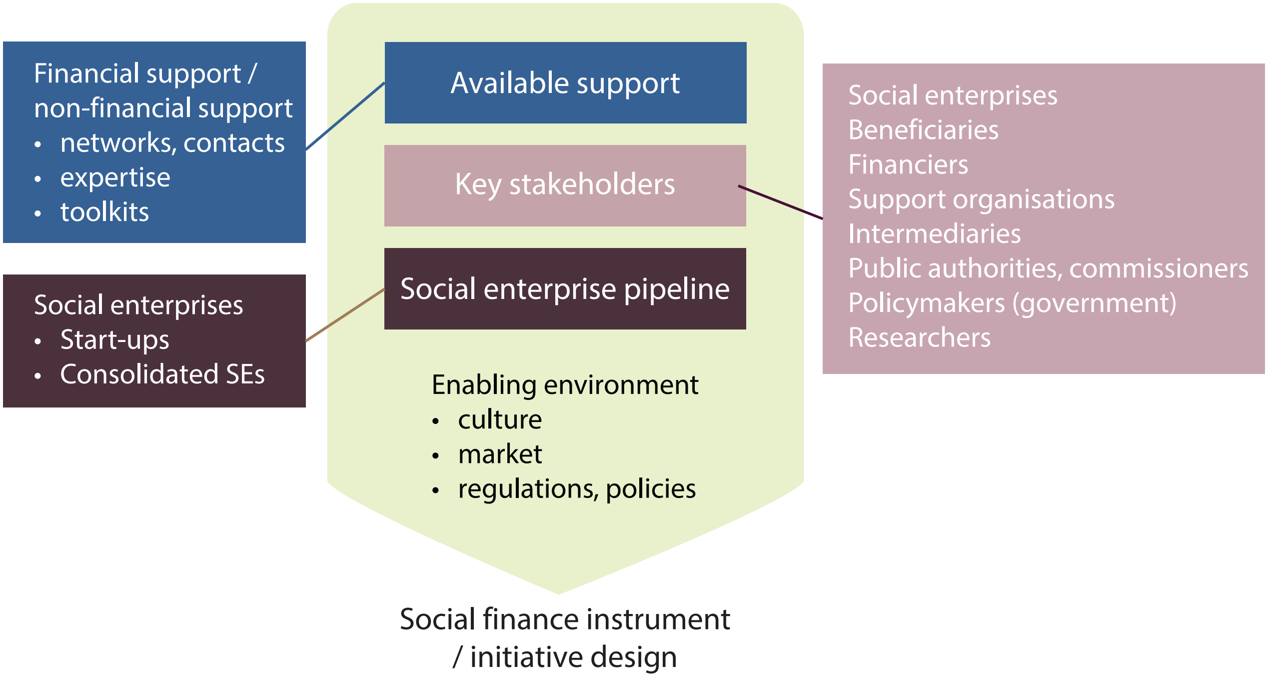
Once the research phase has been completed and the information compiled, you may start to get a feel for the social finance market in your community. You may find that the pieces of the mosaic don't yet fit together, or that many pieces are still missing. The market could still be viable with only some of the elements in place, and it is for you to decide based on your assessment whether you want to be a part of it.

The overall conclusion of the first assessment may be that:

There is space and 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.

18 Based on the final project report submitted by Social Investment Scotland (2015)

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



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?

Which stakeholders do you think you need to collaborate with more closely?

Exercise 1. Availability of financial support/investment

This simple 'staircase chart' may help you to summarise the demand- and supply-side findings of your market assessment. By filling in the boxes with what financing instruments are available in your market and what sources could provide them, you will be able to identify the existing gaps.

	Idea	Start-up, pilot	Consolidation	Scaling
Typical capital need	€0–50k	Up to €100k	€100–500k	Over €500k
Over €1m				
€500K–1m				
€100–500k				
€50–100k				
€0–50k				

‹ *Amount* ›

‹ *Maturity of social enterprise* ›

Exercise 2. 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 the latter as well, in order to find your own niche. The 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–SE development stage axis, corresponding to the above financial support chart.

	Idea	Start-up, pilot	Consolidation	Scaling
Technical skills				
Business planning				
Mentoring				
Coaching				
Peer learning				
Training				
Investor advice				
Matchmaking				
Networks				
Space				
Other				

‹ *Type of support* ›

‹ *Maturity of social enterprise* ›

Chapter 2: Create a vision, define your goals and value added

The market and your role in it

2. Create your vision, define goals and value added

a. Approaches to social investment	b. Advantages and disadvantages of social investment	c. Risk appetite	d. Non-financial support	e. Partnerships and collaboration
Where are you on the investment spectrum?		Types of risk and their consequences		Their role in your vision

You may be an existing or future social investor. Your financial regulator may classify you as a sophisticated or professional 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 or instrument you would like to create and contribute to, and what your value added might be. You may even feel that there is too much information and too many choices, which only serve to paralyse your actions.

Perhaps what you need is a guide that helps you figure out your goals and how you might achieve them. The thing is that even the best guides don't always agree with each other. 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. 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 continually check the sense of it with your social enterprise community. At its core, you may wish to block out the noise of the market place and put a simple and easy-to-follow strategy in place.

Take a look along the continuums referenced in this guide (see Figure 4. Investment spectrum in Chapter 1) and Section 2.2 that follows. Then ask yourself the following questions:

- Are you new to investing or have you previously invested 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, 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? 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 the potential to create social innovation. The 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.

- What is your risk appetite along a continuum from the possibility of losing all of the money you have invested, through an erosion but not total loss of your capital, to preservation of your capital after inflation and an increase in your capital through dividend or interest income or capital gain?
- What will you bring to this investment – just money or other input?
- What is the opportunity cost to you of social investing?

The thought processes that these questions promote should help you draw up a checklist that indicates whether you are a financial investor or a support organisation.

If you are a charitable or other mission-focussed 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. You should consult your legal rather than you financial advisor, and you should also read Stephen Viederman.[19] He sees a chasm between mission, grant making and investment. The logic of synergy seems to be absent.

Social investing is not the same as grant making, but it can be complementary. It brings a steep learning curve and may require different skills and resources. The market, as we know it today, is 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. In part this is because regulators are often playing catch-up in new markets. An example is crowdfunding, whose growth caught regulators and policymakers unaware. So, you may have to deal with varying levels of uncertainty. If you are an endowed foundation or other 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 – both social and financial – are not delivered. In the UK, a small group of charitable trusts and foundations decided to be pioneer investors in the first Social Impact Bond (SIB) because they were already making grants in the same area of interest – and to encourage new investors who would replace them by creating a secondary market in the bond.

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.

Finance first investors prioritise making a financial return and at least preserving capital after inflation on a social investment. 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 (bricks and mortar, typically) where there is strong asset backing for their investment. As indicated in earlier in the chapter, this may be a first step approach by a first time investor or by some 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.

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 generate the potential for higher financial returns, especially where 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 subordinated role to enable more financially attractive returns to be offered to other (finance first) investors.

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

Checklist: Why do I want to make social investments?

Question	Possible answers	Options for action
What are my objectives?	A) I want to help a specific organisation in my community.	Invest directly OR 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 reflects this
	D) I want to bring like-minded people together for a joint initiative.	Form a working group or a subgroup of 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 record, direct 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
	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 below.)	A) I am prepared to lose all or some of my money.	Invest in high-risk social enterprises
	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.	Probably invest through a mainstream impact-investing fund
Can I do this alone or would I be better co-investing? (See also Section 2.5 below.)	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 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[20]
	C) My time is limited.	Work through an established intermediary

20 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.

Table 3. Advantages and disadvantages of social investment for investors and investees

	Investors	Investees
Advantages of social invest-ment	• 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 • Conserves unrestricted cash needed else-where • Vote of confidence in organisation's aims • Potential to increase sustainability • Provides new financial discipline • Opens up a new audience
Disadvantages of social investment	• Can entail a steep learning curve • Likely to require additional resources and skills • Short track record with no actuarial base • Young market	• May need a lot of work to get investment ready • May require culture change • Ongoing scrutiny can divert resources and time • 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 risk	• 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

Source: Rotheroe et al. (2013

You may decide that you want to be somewhere along the continuum rather than at one end, because of your goals or where you perceive you can add value. In such instances you are making mixed motive or blended return social investments (see Figure 4. Investment spectrum in Chapter 1). Similar to grant making organisations that focus on cutting edge research or innovative new projects, there are social investors who 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.

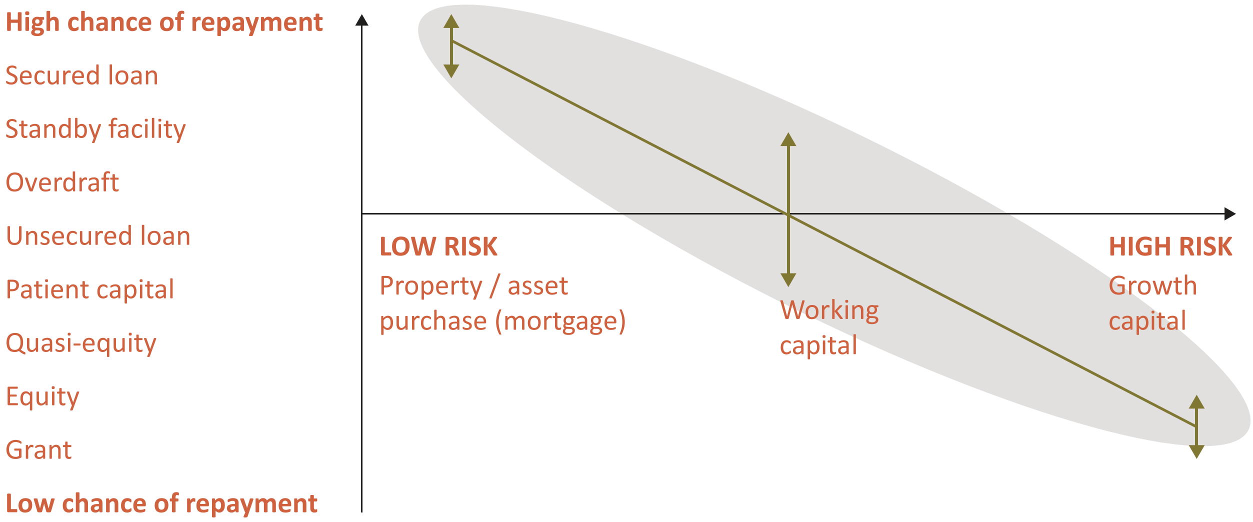
2.2. Mapping social investment onto your appetite: Advantages, disadvantages and risks

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 focussing 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

Figure 8. Matching appropriate funding mechanisms with funding needs

Source: © CAF Venturesome, September 2010. Financing the Big Society



income or profits to social investment? In France, there are a number of instruments that allow you to split your investment between the social sector and mainstream investment. [21]

Do you want to be a proactive, reactive and/or collaborative funder? A proactive investor will seek out investment opportunities in line with his or her 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 2.5).

2.3. 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. As neither social nor financial returns in a social investment are well understood yet, we would add an extra risk: knowledge or information risk. The latter 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.

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 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.

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

21 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)

financial risks are not adequately compensated for by the financial return. These 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.

Liquidity risk is the risk that you cannot exit your investment and that a short-term investment becomes 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. As a result, there has been no refinancing of SIBs and hardly any of other social finance instruments. While refinancing may come over 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 enterprise and relates to its ability to manage higher or lower financial costs.

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?

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 be impacted by **political risk**. For example, the social return from the first social impact bond in the UK was based upon a reduction in the rate of re-offending by short-term prisoners. Mid-programme, the government of the day changed the rules and effectively ended the bond. 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.

The social investment market is young, poorly researched and lacking an actuarial base to its performance data and experience. There is therefore a **knowledge or information risk** that decisions are made without complete information.

The weighing 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.

2.4. Non-financial support offered

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. One outcome you want to see is the creation of more sustainable and accountable enterprises that are better positioned to tackle societal issues. 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. 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.

2.5. Partnerships and collaboration: Their role in your vision

You vision and goals may be very ambitious for you to achieve 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 just work with others as service providers on an occasional basis. More interesting can be the long-term cooperation with potential partners. They should be part of the vision from the start, so that you will find the optimum set up once it comes to structure to accommodate them. 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 offer your

Example: TISE envisaging a social loan fund for Central Europe

Towarzystwo Inwestycji Społeczno-Ekonomicznych (TISE) is implementing a regional project, an impact fund providing 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 are support organisations and/or intermediaries that have intimate knowledge of the field and of individual social enterprises. They have been building the capacity of these businesses and have tried to raise financing for them too, with limited success. The TISE offer would therefore fill a gap, provided that demand and supply can be matched. Based in Poland, TISE has a strong track record in lending to charities and social enterprises in that country, but it needs similar market intelligence and capacity in the other geographies in order to make successful deals. Hence partnering with local intermediaries and support providers has been 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 them would be using external financing for the first time, so that is as much a learning experience as a new financing strategy for them. TISE is confident that it can engage local support organisations and intermediaries in the long run in various stages of the process, starting from sourcing investment deals, through providing business support and monitoring performance. TISE will offer financial incentives to these collaborating partners in the form of proportionate fees in exchange for their services and intervention.[22]

non-financial support to their investees? 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.

The 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 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.[23] (specific, measureable, 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. 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.

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 to/want to cooperate with?

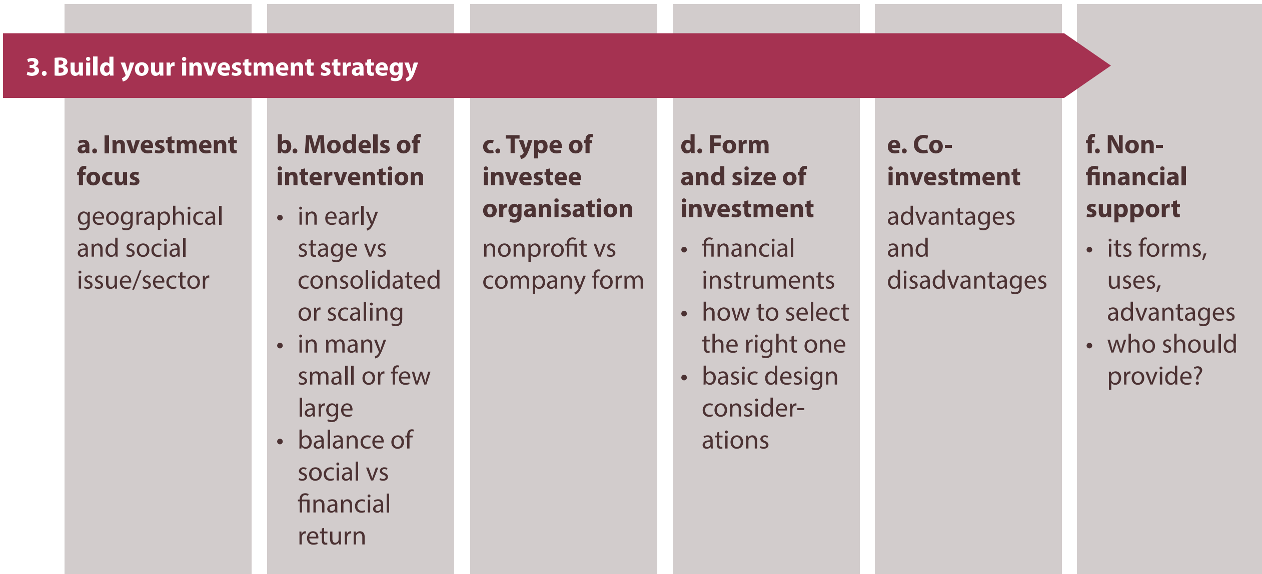
How long are you prepared to give it?

22 Based on the final project report submitted by Towarzystwo Inwestycji Społeczno-Ekonomicznych (2015)

23 See Doran (1981)

Chapter 3: Build an investment strategy

Mixing a cocktail that responds to gaps and risks



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

Using the information of the market assessment, you have created your vision, identified your niche and potential value added and defined your goals as an investor. You are in the position to design your social finance initiative and create your investment strategy. This will encompass six key areas:[24]

1. Investment focus (geographical and sector focus)
2. Models of intervention
3. Types of investees
4. Financing instruments
5. Co-investment
6. Non-financial support.

3.1. Investment focus

The first step is to define your investment focus, namely, what geographical and social/environmental sector 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 and social and economic trends. The market assessment may have identified a 'white spot', 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 2014, which invests only in organisations in the Greater

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

London area due to the mandate of the Corporation and its charitable arm, the City Bridge Trust.[25] 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 exciting idea from outside of your chosen geography. This is one of the reasons that social financiers (and commercial investors, for that matter) approach Central Europe as a region, rather than concentrating on individual countries. Finally, you may need to take into account operational, currency and cost considerations as well when choosing a geographical focus. It is wise to conduct market studies before entering a new geography, which always assumes additional cost, while having investees in distant locations may mean extra operating costs.

Your social finance market assessment may have identified greater need, demand or return potential in some **social sectors/issues** areas than others, for example, in education or healthcare. Choice of sectors might also be influenced by the investor's background or personal passion if he or she feels that their 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 very 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. Increasing your presence in selected sectors can, over time, lead to more successful partnership building and co-investment opportunities and thus increased impact through leveraged resources. At the same time, geographical or sector focus may lead to greater risk due to 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 a component in your portfolio, it may counterbalance some of the risks of your mainstream support.

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. This unfortunately may also mean that they all end up hunting the usual suspects, i.e. the most visible and viable social enterprises, which seem to be the safe investments. Not having a sector focus may also present challenges further down the line, 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.

3.2. Models of intervention

The model of intervention 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. Individual investors may trust their instinct. You may decide to invest in start-up social enterprises, consolidated businesses or growth businesses. You can focus your investment in a few organisations that may be large or require long-term intervention vs a lot of small organisations to show volume and perhaps create pipeline for others. The attraction of crowdfunding to new investors is that you can invest very small sums across a range of enterprises. The 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 is connected to your vision and goals and positioning on the investment spectrum introduced in Chapter 1 and your responses to the points in Chapter 2. Jurisdiction can also play a role in your model of intervention. In French-speaking countries there

25 City Bridge Trust (n.d.b)

Example: Impact Hub Milan developing an impact investment fund for Lombardy

The Impact Hub in Milan decided to focus on start-up organisations in their pilot project following their assessment of market demand and social investment supply in the Italian region of Lombardy. They had identified the gap in the start-up segment, where capital was missing for enterprises to make the transition to a consolidation phase, typically of amounts between €100K and €200K. In addition to capital in this range, the impact investment fund that the Impact Hub is planning to establish will also provide 'soft' support to investees, consisting of mentoring, coaching and networking opportunities.

is much more emphasis on funds than on loans or direct investment.[26]

A note on crowdfunding

Crowdfunding uses internet platforms to seek finance directly from individuals, corporations, governments and institutions. It has grown in parallel with the exponential development of social media and originated similarly in the USA. Along with peer-to-peer lending, crowdfunding makes up much of the online alternative finance market.[27] A benchmarking report in 2015[28] found that the alternative finance market across 255 platforms in 27 European countries grew in 2014 to just under €3b. Collectively across Europe (excluding the UK because of its distorting effect) the alternative finance market provided €385m 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 €201m was funded in 2014 alone. By comparison, the 2014 UK figure was €2,340m, more than a multiple of ten. 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. Others allow enterprises to use what they get. Fundraising is much harder among the crowd than most enterprises realise.

Since 2013, there has been the European Crowdfunding Network (ECN)[29]. One of its aims is to deliver self-regulation. The market in the UK is split; lending and equity crowdfunding are regulated by the financial regulator, while donation and (non-financial) reward crowdfunding are self-regulated. 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. In November 2015, the European Commission published its mapping study to analyse market trends and the impact of national legislations. According to the report, there were 510 platforms in Europe, but less than 40% had useful data.

At least two of the EU pilot projects, I-propeller and Social Impact Hub, have included a crowdfunding platform in their ambitions. It is not clear whether they intend to invest in the architecture themselves or do as an increasing number of social investors are considering and piggyback on an existing platform.

Pitfalls and…

- Where regulation is in place, the regulator is keen to ensure you have the financial means to invest, that you have taken appropriate advice and will only invest less than 10% of your money (UK). Although the rules will be relaxed for US investors worldwide in 2016, the investable sums per person remain modest.

26 Of €6.84bn in 'solidarity savings' in France at the end of 2014, €0.1bn were in savings accounts with banks and mutuals; €5bn were in solidarity funds, only €474m were in direct investments, and €256m were in other products. Source: Finansol (2015)
27 European Commission (2015b)
28 Wardrop et al. (2015)
29 European Crowdfunding Network (2015)

- Crowdfunding platforms do fail, often through fraud or over-ambition. The platform is required to have formal back-up in place so if the platform goes down for any reason, the portfolio and the funds are picked up by the back-up platform.
- 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. Yet Nesta research shows that 66% of equity crowd fund investors regard themselves as retail investors with no previous experience or knowledge.
- While there is interest in a secondary market, it is not expected to exist for another two to three years; therefore investments will 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. The illiquidity issue makes such comparisons misleading.
- 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.

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?

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 its visibility and ensure enough deal flow to ensure your own viability?

How will you manage deal or enterprise failures?

…a few suggestions

- 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. You can have lots of investments between €50 and €500.
- Look to the experts. Let the smart people do the due diligence and then ride 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 in the people?
- Look for the social. Most platforms and investors are looking for high financial returns. Only a few, for example Abundance (UK), offer 'investments that build a better world'.
- Done well, it can make social finance more democratic, with much wider reach.

3.3. Types of investee organisation

Choosing the type(s) of investee organisation is largely a consequence of the goals, sectors and intervention model decision. Your choice is closely connected to what financial instrument 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 focussing on social enterprises, the impact spectrum includes not-for-profit organisations with or without revenue-generating activities, social enterprises, or businesses with a social impact. If your selected social sector is mostly operated by nonprofit organisations, you will have no choice but to choose to finance those. In that case, your choice of financial instruments is more limited, as nonprofit forms can only take grants and loans and possibly some form of patient capital but are generally not eligible for equity investment. 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 nonprofit investees in the pipeline. According to European Venture Philanthropy Association (EVPA) members NESsT and Oltre Ventures, who provided input for the *Learning from Failures in Venture Philanthropy and Social Investment* publication, nonprofits are difficult to move to sustainability and their revenue generating potential is limited if they are not willing to seriously engage in entrepreneurial solutions. This in turn may mean that their large-scale social impact potential is limited as well. This has implications for the social return of the portfolio, a key consideration when you are designing the investment strategy and which may lead you to consider hybrid instruments in your portfolio. The 2014 Impact Investor Survey shows a clear preference for the types of investees of this segment of investors: 89% of allocated capital was invested in post–venture stage businesses, including growth stage (35%) and mature (44% in private and publicly traded)[30] rather than early stage and start-up enterprises, where unmet need is most apparent.

3.4. Form and size of investment

At its simplest, social investment works by investors providing finance to an enterprise, which the investee then uses to expand its operations, develop new income streams, fund working capital or reduce costs. These investments need to have an attached income steam or cost-substitution effect that is sufficient to cover not only operating expenses but also repay the investor, usually at interest (e.g. mortgage payments, which may be less than rental costs and which also give the enterprise security of tenure).

On the surface, there appear to be a wide range of social investment products, but most fall within one of the three main categories referred to earlier: 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 upon period, sometimes on an interest-free basis, other times at a pre-agreed rate of interest. Historically, social investors have charged interest on an affordability basis rather than pricing the loan on the perceived risk. Debt is spread across **secured loans, unsecured loans** and **bonds**, as shown in Table 1 in Chapter 1 and covered 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 his or her funding. Many third sector organisations do not have structures to permit them to issues 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. 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. Recent community share issues originated in the UK, but they have since spread to more than 20 different European countries as well as North America, where they have financed community sports enterprises such as ice hockey clubs. However, where equity is provided it should be regarded generally 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. One reason that social enterprises are reluctant to be listed on mainstream exchanges is their desire to protect the 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 so 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. They often take the form of revenue participation agreements (see glossary).

These are all direct investments. You can also make contingent investments, for example, by providing a **guarantee** to a third party on behalf of the enterprise or by **underwriting** an amount that may encourage further investors or which you may be willing to provide at a later date. Again, guarantees are addressed in more detail in the glossary.

3.4.1. Financial instruments

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 using City of London know-how and structuring techniques. There is a growing amount of literature about this instrument, which is referenced in the glossary. SIBs are basically

30 Saltuk (2014)

Example: Social solidarity investment in France

Over the past 40 years, France has introduced financing tools for solidarity organisations, including social enterprises, with particular regard to their ability to absorb equity. 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 (for retirement), low-rate savings of employees of a companies 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. The solidarity investment fund regulation has been changing ever since, and by 2013 had resulted in total assets under management of €3.7bn.[31]

contracts where 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 with social investors who provide the capital for (a) 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.

Equity is often in the form of ordinary shares, although in mission-driven enterprises preference shares are also in issue, separating out the governance of the organisation from the preference for dividend payments. Some values-based financial intermediaries, e.g. Triodos Bank in Europe, issue so-called depository receipts. These enable the enterprise to raise new capital while ensuring that the organisation cannot be taken over by a hostile bidder and protecting the mission and values of the enterprise. Ownership and risk to mission are of fundamental importance to a social enterprise in negotiating the injection of new capital.

Quasi-equity often involves an investor providing finance to enable a future initiative to get off the ground that may generate income for the enterprise further down the road. 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 *de minimis* 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 can often require the investor to be flexible in his or her approach.

Hybrid finance has sought to reconcile some of the basic tensions between the financial requirements of investors and the impact motivation of social entrepreneurs and 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 like a swap or forward option and mixtures of debt and grant. There has been much debate as to whether these are to be classed as equity or debt, and you should take advice if you are considering either using or investing in them. Many have been translated straight from the investment banking world and will only be of relevance to sophisticated investors or the very few social enterprises with skills to manage them. Initially, advisors sought to reconcile tensions in social enterprise by developing new corporate structures, such as a low-profit limited liability company (also referred to as L3C) and Community Interest Company (CIC), but these have not found a balance

31 Dupuy and Lagendorff (2014)

between the interests of investors and enterprise. A more recent initiative has been the issue of flexible low yield (FLY) paper by Google. FLY paper removes the financial temptation for entrepreneur and investor defection. 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 a robust off-the-shelf remedy for the mistrust that keeps social investors and entrepreneurs apart.[32]

3.4.2. How to select the right 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 your jurisdiction. This can be difficult if you have little experience of making social investments. In some cases, you could just give the enterprise the money, but you are attracted to the idea of a loan and it is feasible. However, a grant may be more desirable in the eyes of the enterprise because no repayment is required.

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 to repay an investment? **If yes, keep going.**

Does the sector in which the enterprise operates have a track record of such investment? **If yes, you are on the right road.** If no, 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, fine.** If no but the enterprise is moving in the right direction, you may still say yes.

Is the model tested already and proven to generate social and financial returns? **If yes, go ahead.** If no but you are prepared to take the risk and back the people, go ahead, although you may consider a lower amount.

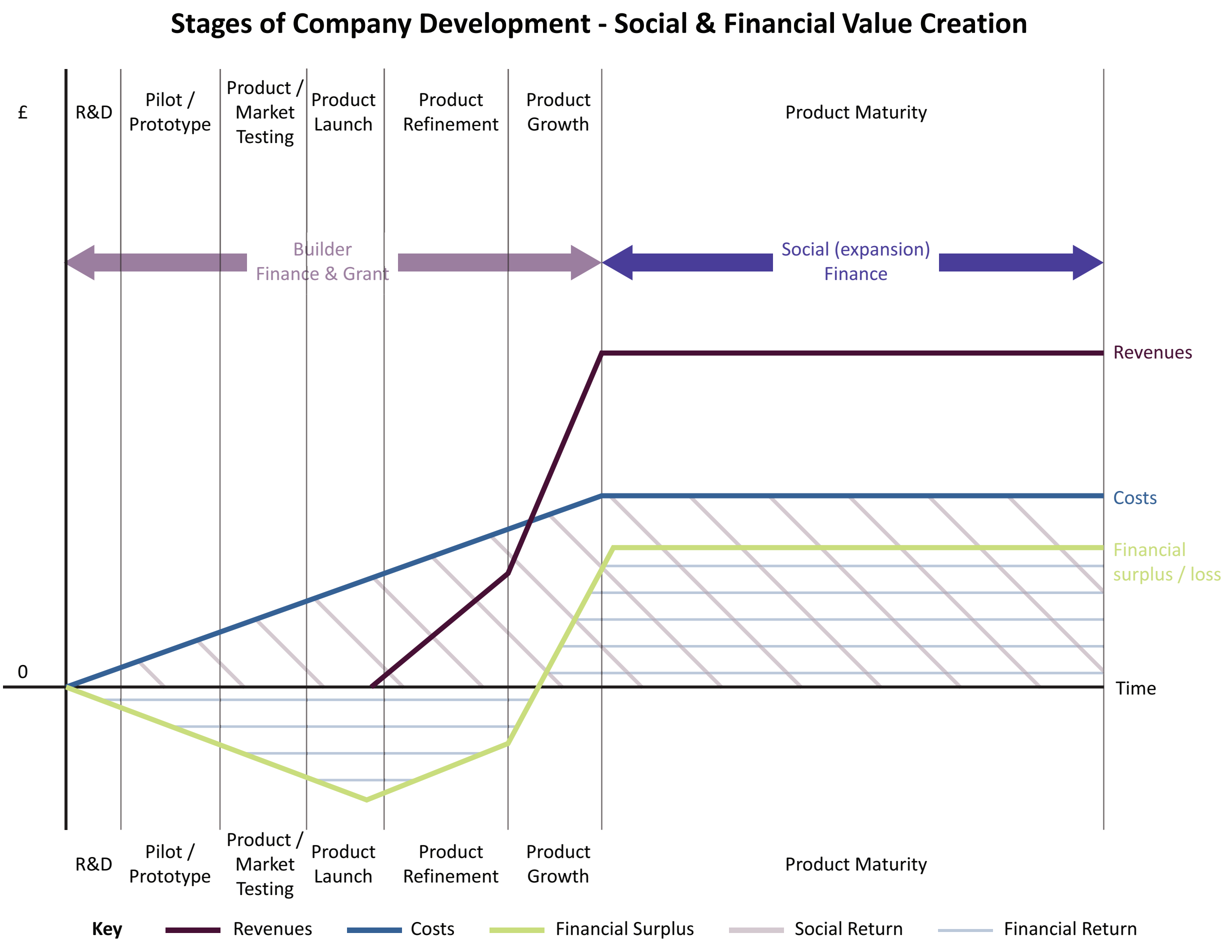
How you answer these questions may help you to determine which type of instrument you may wish to choose. If the answer to all of the above questions is 'no' and you still want help the social enterprise, you can give a grant. Not all activities that an enterprise undertakes will provide income immediately or, indeed, ever. As Figure 9 shows, the first phases of product development and launch assume increasing investment and costs and slowly increasing revenues for the social enterprise. This is when the business is making losses, but the social return may already be significant. Here a grant may be appropriate alone or alongside investment, but there may be an appetite to provide a high-risk investment either by 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.

Social investment covers a range of assets, from cash to property. Figure 10 below gives some examples. A fairly full guide to the different types can be found on the KnowHow website.[33] As has been pointed out, the majority of social investment to date has been loan driven, often by values-based banks. There is strong demand for patient or start-up capital. If we plot the investment objective, along an axis from purely social to purely financial, against the risk profile of the investor, we see that the best-aligned finance is 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, better understanding risk and

32 See Burgess (2014)
33 KnowHow (n.d.)

Figure 9. Social and financial value creation

Source: Davison and Heap (2013)



willingness to accept it. Short-term solutions can include partnerships and mixed funding.

3.4.3. Basic design considerations

The most important consideration is that your support is seeking to help the enterprise achieve its goals or mission. Its design 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 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. If the cost of repayment is small compared with the benefit accruing from scaling up, then this is acceptable, but it should not be overlooked that the costs of repayment risk placing a future burden on investees. This is why many social investments do not price fully the risks they are taking.

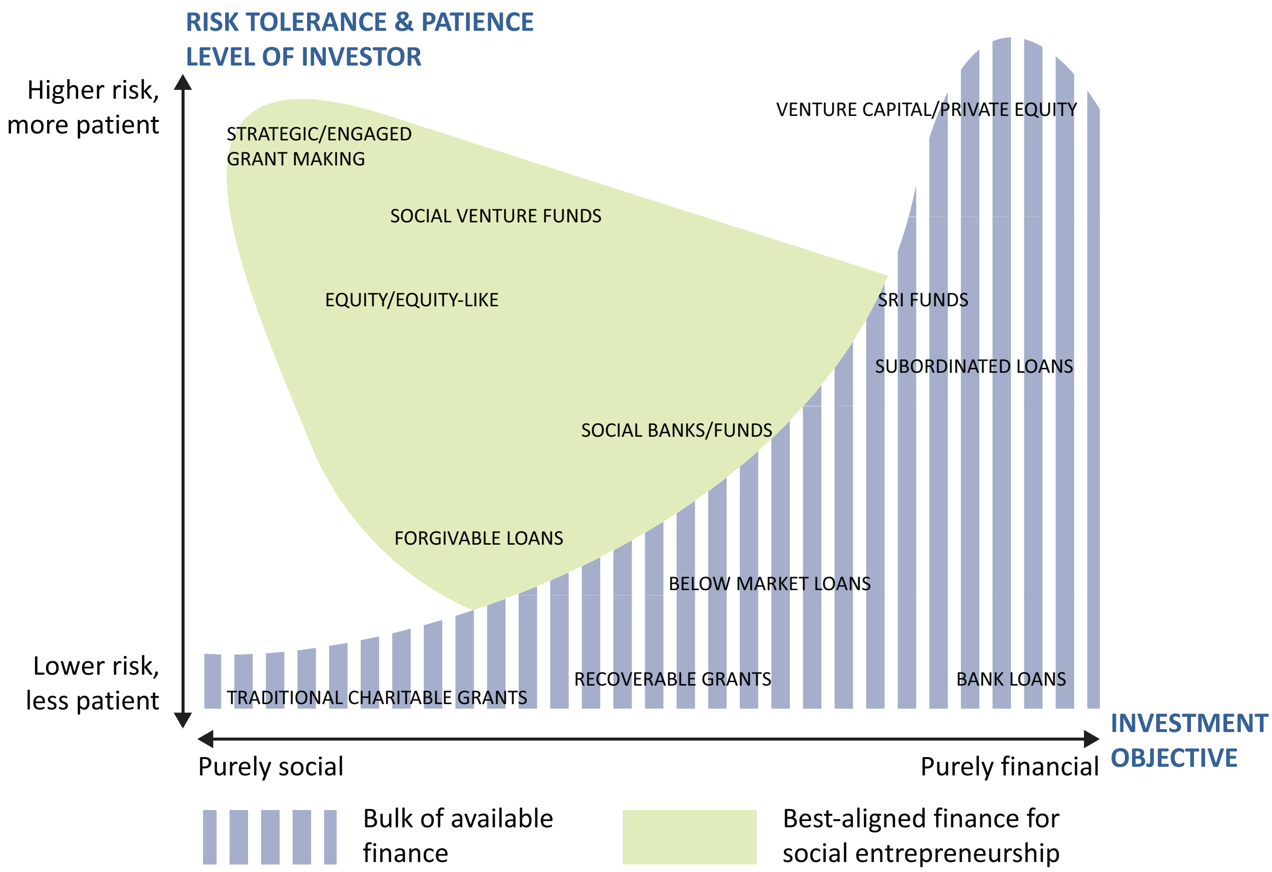
The key in venture philanthropy (VP) is to select the tool that offers the best fit. The business case of the social purpose organisation SPO, rather than the VP fund's preferences, should be the primary determinant. Nevertheless, as part of its general investment strategy, the VP fund will need to assess in advance which instruments it plans to employ.[34]

Another design consideration is, if you take security, what will you do if the investee defaults? Will you

34 Balbo et al. (2010)

Figure 10. Investment opportunities in social investment

Source: © Skoll Centre for Social Entrepreneurship, 2008. The landscape of social investment, Alex Nicholls with Cathy Pharoah, Skoll Centre for Social Entrepreneurship, March 2008 (adapted from Alter, K. 2007. Social investment, presentation at Saïd Business School, 19 April)



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 a refinancing has to take place and to position their interests relative to those of other investors.

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 2.2). However, if you want to invest in several specific sectors that may be 'unfashionable' at the same time, you may struggle to find a fund that meets your objectives.

3.5. Co-investment: Advantages and trade-offs

Co-investment can be an important part of the investment strategy. The key condition, of course, is that there be potential co-investors present in the market and that they be open to such partnerships. This is something that should have become clear during the assessment of the market. In an ideal case, you should have identified a number of possible co-investors. If there is a pool of possible partners, you need to decide whether you need them at 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 with special industry expertise that you can't access otherwise? At what point during the lifecycle of the investment do you want to include them: from the beginning or later, for follow on investment with you at a consolidation or during the growth phase?

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:

Table 4. Advantages and disadvantages of involving co-investors

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

Source: Adapted from Balbo et al. (2010)

- 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, who coordinates co-investors of different interests who may even be providing different types of financing, for example, to create a hybrid financing package.
- Are the co-investors in the same position on the investment spectrum as you? If you defined yourself as an impact first investor, you will be looking for impact first co-investors as well, whose interests in achieving social impact are likely 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 good standing and reputation? Do they have investment experience in your sector/area?
- Are they willing to share the burden and cost of management?
- Can you foresee potential problems upon exit in the future?

Having selected the co-investor, it is crucial that you both agree on the roles and responsibilities up-front. This includes not only the financials, but also who does what in the investment process: 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 those to your co-investees.

3.6. Non-financial support: Its use, forms, advantages and sources

Non-financial support is seen as a key component for social investors who wish to engage with their investees. As explained in previous chapters, non-financial support has an important risk-mitigation purpose, so this is something to take into account when you are deciding if you wish to include it in your investment strategy. You can provide non-financial support directly, if you have the means and skills, or you can outsource this to a support organisation. In any case, the provision of non-financial support is resource intensive, so it needs to figure in your cost calculations as well, not only in the strategy.

Investees usually appreciate non-financial support a great deal, because it brings them benefits that they would not have access to otherwise. But 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

Example: FASE 'hybrid' financing deal-by-deal

In its pilot project, Finanzierungsagentur für Social Entrepreneurship (FASE) was testing its model of cooperation and co-investing of different financing partners for social enterprises. FASE played the role of an intermediary, bringing different types of investors to the table around a specific investment deal, but also the role of the advisor support organisation (through external coaches), helping the investee organisation become ready to absorb the investment. Four out of five social enterprises selected and developed have successfully received a financing package for growth capital, combining impact investments through mezzanine finance (quasi-equity) with features such as revenue or profit participations and impact incentives with equity or donations and quasi-equity and – in one case – with 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 enterprises, while mezzanine finance was a more suitable solution for so called '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 lifecycle financing and, for the participating investors, reducing their risk and testing new cooperation models. FASE identified high demand for such intermediary services during its pilot project and is therefore planning to scale the model. The pilot demonstrates that the innovative combination of existing financial instruments can channel significant resources into selected enterprises, approximately €3m in this case. At the same time, it is a very resource-intensive process, which therefore might be challenging to implement and can only be scaled successfully in its current form if an increased market volume allows more deals per year.

with mentors, attending networking events or participating in training sessions. A realistic assessment of the capacities of your target investees will help you decide at which point and at what level non-financial support is feasible.

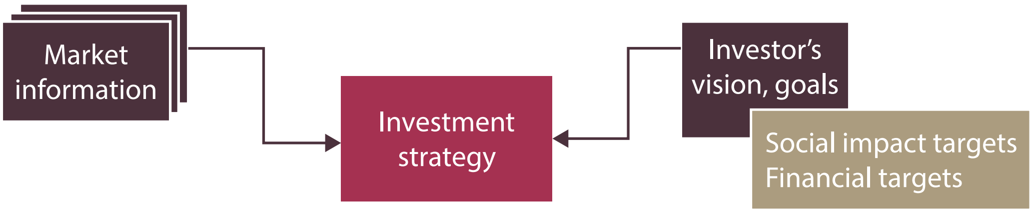
Another challenge with this element of the investment strategy is that it is hard to assess its impact on the social enterprise and its social impact. There are indirect ways to calculate the impact of non-financial support using input data (such as number of volunteer hours) or output data (number of 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. How much knowledge is retained by that person or passed on into the corporate memory?

Example: Investment strategy City of London Corporation Social Investment Fund[35]

The City of London Corporation launched its £20m 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. 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, the Fund aims for capital preservation plus financial return: 'total return equivalent to the CPI inflation rate (2.7%) on the day that the allocation was made', which is required because of what the source of funding is. This in turn has implications regarding the size and types of investments the Fund can make; they are typically no smaller than £250,000 and are financing well-established organisations that are able to absorb and repay finance. The Fund does not provide non-financial support to its investees.

35 City Bridge Trust (n.d.a)

Figure 11. The investment strategy design process



Geographical focus	Sector focus	Model of intervention	Type of investee org.	Co-investment	Non-financial support
• Size of investee pool • Costs	YES • Focused impact • Expert in sector BUT • Limited pipeline NO • Wider reach • Demonstrate model BUT • Costly	START-UPS • Many small • Develop pipeline • Innovative ideas • Expert in SEs BUT • Cost, time consuming • Risky • Social impact measurement challenge CONSOLIDATED OR GROWTH SEs • Few large • Financial viability • Significant impact potential BUT • Needs large investment • Needs developed market/pipeline	NONPROFITS • Limited menu of financial instruments • Few are scalable BUT • Strong social innovation ideas SEs • Scalable • Financial return potential BUT • Possible trade-off between social and financial return	YES • Shared risk and returns • Additional resources, networks • May help sourcing deals • Can significantly increase social impact of investee BUT • May cause conflict at exit NO • Full control • Get all social and financial returns BUT • No risk sharing	YES • Increases effectiveness of investment • Builds SE capacity BUT • Costly NO • Outsource BUT • Distant relationship with investee • Uncertain quality

Summary questions for Chapter 3

What are the key elements of your investment strategy?

What might be ways to operationalize your strategy?

What are the biggest challenges that you expect to face when implementing it?

What trade-offs do you expect to make?

Chapter 4: Build your intervention strategy

Non-financial support: Addressing the lack of investable social enterprises

4. Build your intervention strategy

a. Providers of non-financial support	**b. Investment focus**	**c. Type of investee**	**d. Intervention models for support**	**e. Partnerships and collaboration**	**f. Other sources of support**
• Support organisations • Incubators • Accelerators • Intermediaries	• Geography • Social sector	• Blueprint • Scaling focus	• Demand- side support: group vs one-on-one • Selecting SEs for support • Outsourcing support • Supply-side support: intermediaries • Product offer		• EU structural funds • National-level public funds

This chapter is about your intervention model, if you are not a financial investor. Your market assessment will have given you an indication of the stage of development of the market you are operating in, whether it is a nascent or mature market, and what the key barriers are on the demand side, i.e. the investment opportunities. In Chapters 1 and 3, we considered the barriers to social investment from the social investor's perspective. In this chapter, we will continue to use the perspective of the investor or support provider, but we will focus on one key barrier: lack of viable enterprise models to invest in. Considering the findings of the market assessment, Figure 12 summarises what the general goals can be for support provision.

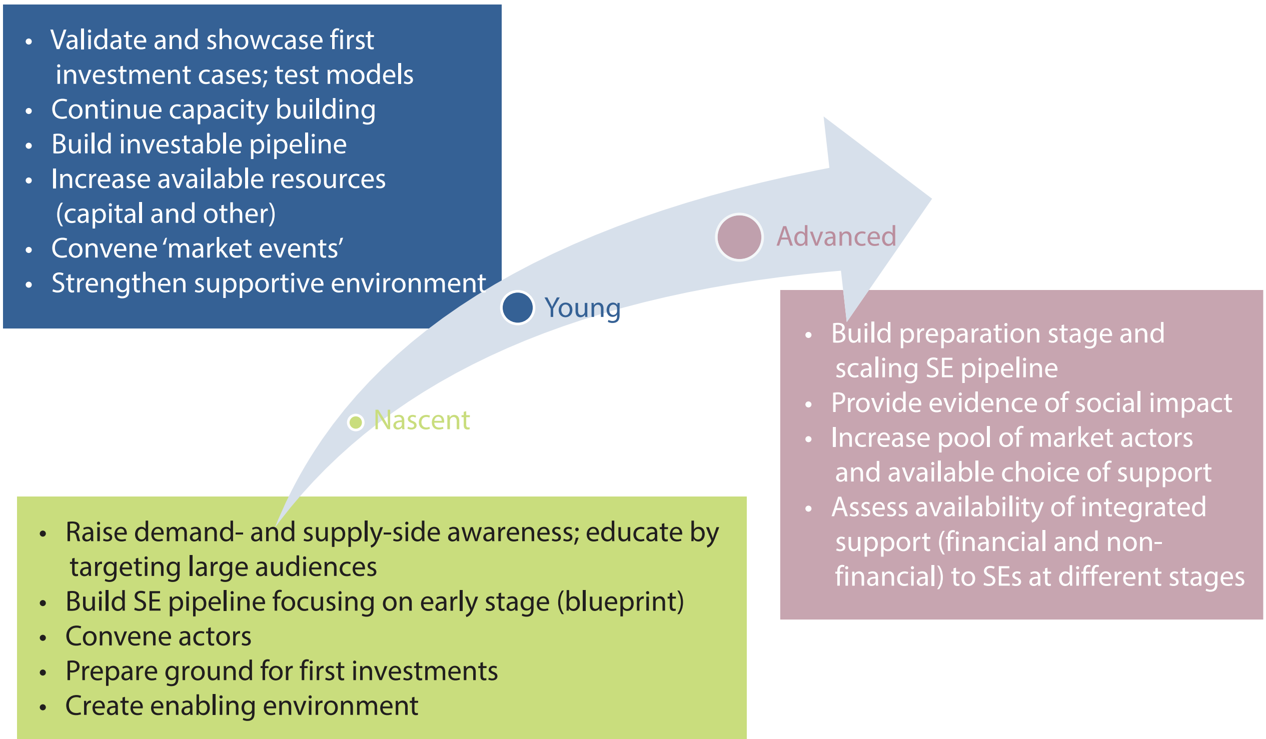
Based on your market assessment, you have also have identified what non-financial support is available to social enterprises and what may be missing. You know where the knowledge gaps are and who else is active in the market. From this information, you have developed your vision, decided where you would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

- Investment focus
  - Geographical focus
  - Sector focus
- Types of investees
- Models of intervention
  - Product offer
  - Financial support
- Collaboration with others

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 growing.

One of the first questions you need to answer before you even look at the above list is whether

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



you consider yourself an investor, i.e. are you in it for the long run. Unless you are an equity investor, timeframe is a given for most of the financial products, but non-financial support can be offered indefinitely or as a one-off support. 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, or should you enter the market in cooperation or in competition?

4.1. Providers of non-financial support

In the above chapters a lot has been made of organisations that provide non-financial support to social enterprises. As explained in Chapter 3, it is often the investor itself that chooses to offer non-financial support to its investees in order to minimise risk and maximise the social (and possibly financial) return. Support providers cover a range of nomenclatures, which are illustrated in Table 5 below. In less developed markets only a few of these might 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 box). In more advanced social investment markets, there is a whole industry, including the entire range of support agencies, which may focus on certain types of social enterprises or select specific sectors only or decide to offer a complete range of support and services to the sector. Some may focus only on investors and offer 'investor readiness' advice, while intermediaries want to 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 ideas into reality. Reviewing the above types of support organisations, and what it takes to add value through them, should provide input into your decisionmaking process about what the best fit would be for you. 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

Example: Oksigen integrated support package for social enterprises

Oksigen in Belgium is a group of companies that considers itself an 'ecosystem of support organisations with a shared mission that offer a broad range of capacity and scale-up services to organisations targeting social impact'.[36] Oksigen Lab conducts research and offers coaching to social enterprises, the focus being 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, i-propeller is the consultancy in social business innovation and shared value. Oksigen companies could be considered stages of development of a social enterprise, where an enterprise enters at the idea development end 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. This 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 is continuously improved; in the pilot project, Oksigen launched OksigenCrowd for donation / reward crowdfunding, which is being integrated into a larger crowdfunding platform for social impact, in partnership with Bank Degroof / Petercam and several Belgian foundations.

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 intermediary 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.

4.2. Investment focus

Similar to financial investors, non-financial 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 more emotional or personal motivation. Non-financial support is very contextual in nature, so it is often local and is most effective if provided in the local language. If markets are small, non-financial investors may decide to set up a regional model, which is more cost effective from their point of view and may provide learning benefits for the 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 financial investor considerations. 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.

4.3. Types of investee organisation

If you are a support organisation, you may target your support to certain 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

36 Oksigen presentation at pilot project workshop in Brussels, June 2015; Oksigen (2015)

Table 5. Non-financial support providers

Type	Features	What does it take to become one?
Support organisation Provides mostly non-financial support to social enterprises (SE); this generic term includes the categories below	• May target SEs of different levels of development and size • Usually supports few SEs • Support can take different forms and is often long-term • Support given for varying durations • Often runs investment readiness programmes • If it offers funding, it is 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 SEs long-term • Has funding for own organisation as well as SEs
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 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 large number of SEs going through • Funding for own organisation as well as SEs • Premises
Accelerator Helps existing businesses accelerate their growth	• Focuses on existing SEs • Provides a variety of supports, including mentoring • May offer seed capital in exchange for part ownership • May connect SE 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 way to identify promising SEs • Funding for own organisation as well as SEs
Intermediary Connects social enterprises with suppliers of finance, expertise, beneficiaries and customers[37]	• Provides tailor-made services to SEs and/or investors; 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 SE sector • Good system of scouting out investable investees • Investment readiness programme, if necessary

37 In this guide we focus on this type of intermediary and not those that are investors themselves. Impact investors consider other funds or fund managers as intermediaries as well and 40% of the assets under management are invested through intermediaries; this applies mostly to emerging markets. Source: Saltuk (2014)

to be the biggest and because social investment markets need a continuous and large pipeline of potential investees. Impact investors' single largest challenge is the shortage of high-quality investment opportunities with track record,[38] and they are waiting for other players (government or support organisations) in the market to address this. The lack of investable propositions is a gap even in developed social investment markets, so early stage support is a must. This is reflected in global surveys as well: 80% of GSEN members (defined as support organisations) target idea stage social enterprises, while 93% have targeted the prototype stage.[39] This is in strong contrast with data on the impact investment industry, where 78% of the global investments in emerging markets targeted growth stage companies in 2012.[40]

How to find them

Support organisations often operate with an open call for proposals to find the social enterprises they want to work with. 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 (that is, to cherry-pick), open calls may be the way to go. Online tools and social media make this relatively cost effective nowadays. Before deciding to announce your call, 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, and clearly communicating to, your target audience is of key importance; are you targeting idea stage or growth stage enterprises? Working with partner organisations may offer the solution to the promotion issue, 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 requires a clear set of criteria and a selection system. Depending on the intervention model you have opted for, you may want to select a large number of organisations or reduce the numbers from the beginning. If you are planning to run a group support programme, the former works very well, while for one-on-one you will need to be very selective. Some organisations, for example, NESsT or UnLtd, start their tailor-made investment readiness programme with a large pool of organisations, but reduce their numbers drastically in the first round. The feasibility study stage at NESsT selects out organisations whose social enterprise idea seems 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 value added.

You can create a scoring tool in which these elements each carry an assigned weight and you can thus calculate a score for each social enterprise assessed. Following this, it is up to you to decide what to do with the organisation that has not been selected. Have you got resources 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 business model and apply again in a possible next round?

4.4. Models of intervention

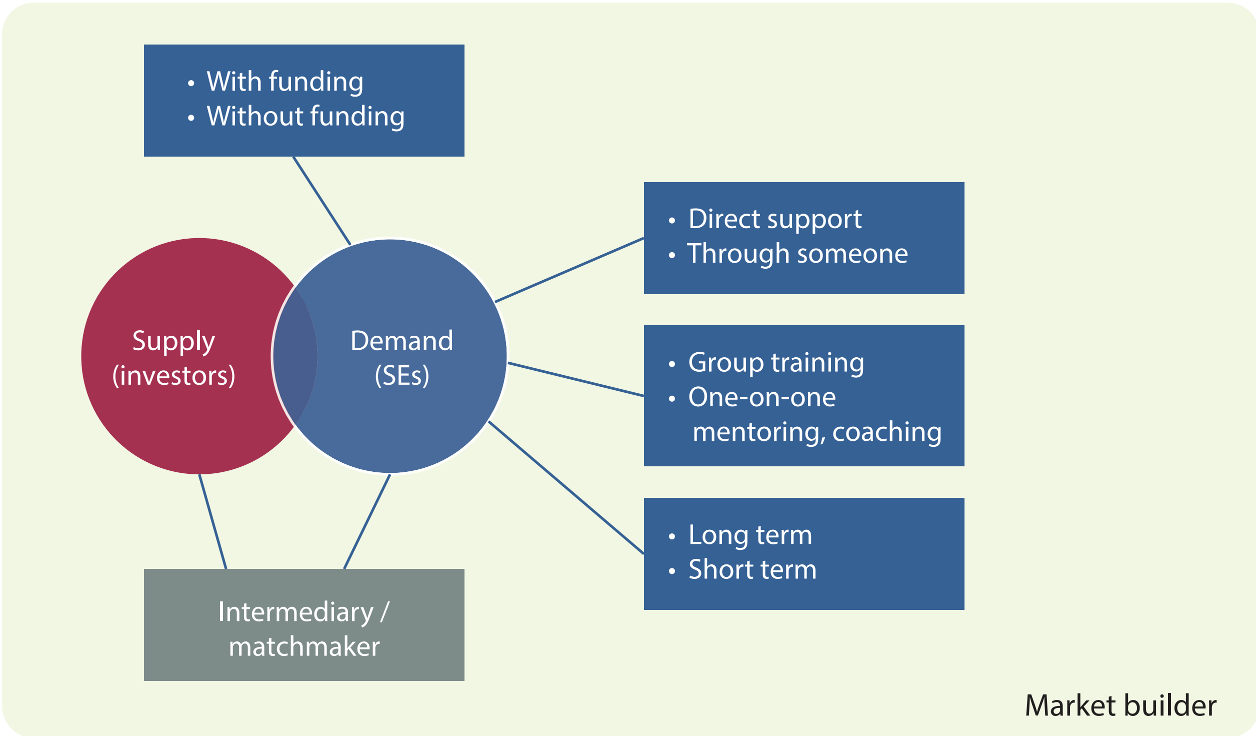
A framework for the design of non-financial support could look like the one in Figure 13.

These are the questions you need to ask yourself:

- Will you provide the support yourself or through someone else?
- Do you address the demand side or the supply side?
- Will you use a group approach or a one-on-one approach?
- Will you provide short-term or long-term support?

38 Saltuk (2014)
39 Idea stage: Conceiving and developing an idea to solve a social problem. Prototype stage: Developing, piloting and testing the idea/the entrepreneurial model. Source: Longair and Tora, supported by UnLtd (2015)
40 Growth stage: Company has positive EBITDA and is scaling output. Source: Saltuk et al. (2013)

Figure 13. Non-financial support framework



- Will you provide funding?
- Will you play a matchmaker or market builder role?

4.4.1. 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? 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 piece of the puzzle, and non-financial support is key to unlocking badly needed capital.

How can you create an (investable) social enterprise pipeline out of nothing? The answer is: 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. Good practice examples can help prepare the ground faster or with fewer mistakes, 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 only your 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 can be a logical step. Different kinds and levels of support are required at different stages of market development, just like different support is required by individual social enterprises at different stages of their lifecycle. As a market develops, its segments become more populated and ideally different types of support at all levels at all times become available.

Group support: Training

One possible intervention model may be group support. This is especially cost effective if the demand side 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 be the best way to go

Example: Competitive awards of UnLtd

A good example of award schemes is offered by UnLtd in the UK. The awards[41] focus on different target groups (e.g. young entrepreneurs or universities) or geographical areas (London's East End or the borough of Tower Hamlets). Through a competitive process, UnLtd offers support to social entrepreneurs at various stages of their journey. The best known of their investment readiness programmes is probably Big Venture Challenge (BVC), which is an award scheme as well. It is a 12-month intensive programme designed to help selected entrepreneurs win investment (debt or equity) of £50k–500k. This means working with them on growth business models and strategic connections to investors and providing match funding to complement the private investment raised. BVC is a matchmaking programme as well, as it constantly appeals to private investors to invest in social enterprises with potential that have been identified.

if the objective is the transmission of information, sharing of learnings or building of skills. Schools of social entrepreneurship or various training programmes are good examples of this approach. Except for social enterprise manager degrees, these programmes tend to be short term, are sometimes theoretical in nature and can lack follow up.

Award and competition schemes have become widespread and popular. If paired with support elements, they can be an effective way to build investment pipeline, build capacity and select social enterprises with impact and growth potential. The award offers an added incentive for participating organisations and helps 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.

One-on-one support: Mentoring and coaching

Unarguably this is the most effective approach if the objective is to support enterprise development from start to finish and to go deep with a few organisations rather than shallow with a broad range of them. It may be the only approach if the support programme aims to accompany social enterprises from start-up to scaling phase. One-on-one support often shapes up in a portfolio approach, whereby the support organisation keeps a 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 enterprise with varying return potential. The individualised approach is reflected in the menu of tools and instruments as well: coaching, mentoring and tailor-made capacity building dominate, and even the use of standard tools and templates is accompanied by tailor-made advice. Non-financial investors have a larger stake in their investees that are supported one-on-one – literally if they invested capital in them (for example, accelerators), but also symbolically, 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 investor and investee.

DOs and DON'Ts of demand-side support models

DO use the group training if you have expert and knowledgeable trainers who give credibility to the course and 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 need is more for tailor-made support or if your target group is too disparate in space and it is not practical to bring the members together. It is worthwhile to note that technology allows this last challenge to be overcome, as group support is increasingly offered online in the form of web platforms and webinars. These serve the knowledge transfer purpose well; however, they can be very impersonal and theoretical.

41 UnLtd (2015)

Example: Social Impact Lab Start-up Support programme: Concentrated one-to-one

'Our focus is to support 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 eight months of professional consultancy, coaching, workshops and co-working workplaces. Social Impact also offers start-up programs for special target groups.'[42] Social Impact Lab Start-up Support is a relatively short support programme, but it offer a mix of support and may lead the organisation to using other services of Social Impact GmbH, such as the crowdfunding and finance support (Social Impact Finance) or the professionalization and scaling consultancy (Social Impact Consult). Social Impact works successfully with partners and funders where there is that type of support to draw on. That makes start-up support possible at the local and regional levels. The support can also target 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.

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. Otherwise you may only get a few applications, which may do you a disservice in the long run.

DO use one-on-one support if you are want to demonstrate a particular model or want specific social outcomes and impact. This is also the best form if you prefer to create your own investible social enterprise pipeline for other programmes.

DON'T use one-on-one approach if you haven't got the resources to invest over the long run. 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 disseminated.

Group and one-on-one support may be successfully used in combination if the support programme requires basic information and knowledge transfer and/or if the group setting is needed to select participants for a further one-on-one programme component.

What are investment readiness programmes?

Investment readiness programmes are non-financial support programmes that target organisations and social enterprises that aim to take on social investment specifically. The goal is to put them in a strong position to present their enterprise to different investors and to meet their requirements. Investment readiness focuses on the business model, usually growth and scaling, social impact potential and governance aspects of the social enterprise, while also building the investee's finance skills and management experience.

Should you provide non-financial support yourself or through someone else?

This consideration assumes that other players exist in the support segment of the market who are capable of delivering non-financial support to social enterprises, that is, consultants, support organisations or intermediaries that can be funded to provide support. Such an indirect way of providing support may be viewed more as a market building activity, and it typically takes shape in a large, funded programme. The mechanism would allow 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. While this programme could be considered as long-term

42 Social Impact (n.d.)

Example: Social Enterprise NL Next Level Programme

Next Level, the investment readiness programme of this pilot project, was designed with the aim to 1) prepare social entrepreneurs to successfully obtain social investment and 2) actively connect entrepreneurs to impact investors. The programme ran for three months and offered five intensive full-day sessions to the social entrepreneurs, who had the opportunity to work as a group as well as individually with coaches, build their skills and meet with investors. During the program, 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 program and were challenged by their coach and several investors. An important outcome of the pilot project for Social Enterprise NL was learning about what social enterprises need to be better positioned to convince investors. Social Enterprise NL will use this learning to improve the Next Level Programme for future conducts. In addition to skills, social enterprises need access to investor networks and to learn the language that they speak. 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 their investor networks. As a concrete outcome of the programme, all entrepreneurs met with several investors. Some have learnt to grow without new equity; some have found an investor or are still in discussion. Growth is not within reach for all entrepreneurs.

support from the funder's point of view (if it runs over several years), it probably means a short-term, one-off capacity building or investment readiness intervention from the perspective of the social enterprise.

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 may want to choose this indirect 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 example later in this chapter and also Section 4.5 for key considerations for partnerships. You can decide to pay for the support provision to the support organisations directly or 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. 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.

4.4.2. Supply-side support: Advisors and intermediaries

If your conclusions tell you that important barriers to growth are on the investor side, you may wish to

Table 6. 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 last short-term and focus on specific outcomes (e.g. obtaining one investment)
The social enterprise is placed in the position to contract the best tailor-made support possible	There is no or only a limited relationship between the funder and the supported social enterprises

Example: Clearly Social Angels

ClearlySo runs the first impact angel network in the UK.[43] This is an intermediary activity. At the same time, the organisation plays an important market builder and investor educator role as well. Angel investors that join the network are exposed to new ideas and new investment opportunities on a regular (monthly) basis; ClearlySo introduces them to social entrepreneurs looking for debt or equity in the £200k–1.5m range. Network members pay for the service. Using the 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 investors segment by offering structured impact investment opportunities (debt, equity, 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.[44]

focus your support on the supply side. Yet even here you may choose between different models:

1. If the barrier is the lack of understanding of the social sector by investors, you may choose to become an investor advisor or provide investor training and capacity building.
2. If the barrier is access to investments or 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.

There is a diverse toolkit at your disposal in either case, 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[45] or the Social Enterprise Day hosted by NESsT[46] are good practice examples of how to educate investors and create a concentrated meeting of supply and demand.

In addition to finance, intermediaries may also be active in a number of other 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 intermediaries that are facing towards beneficiaries (monitoring) can include specialised measurement consultancies. Policy intermediaries may include umbrella bodies of social enterprises or researchers, who 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 above example of ClearlySo illustrates this well, as the company runs investment readiness programmes to connect social enterprises not only with financing options, but also with expertise.

4.4.3. Product offer

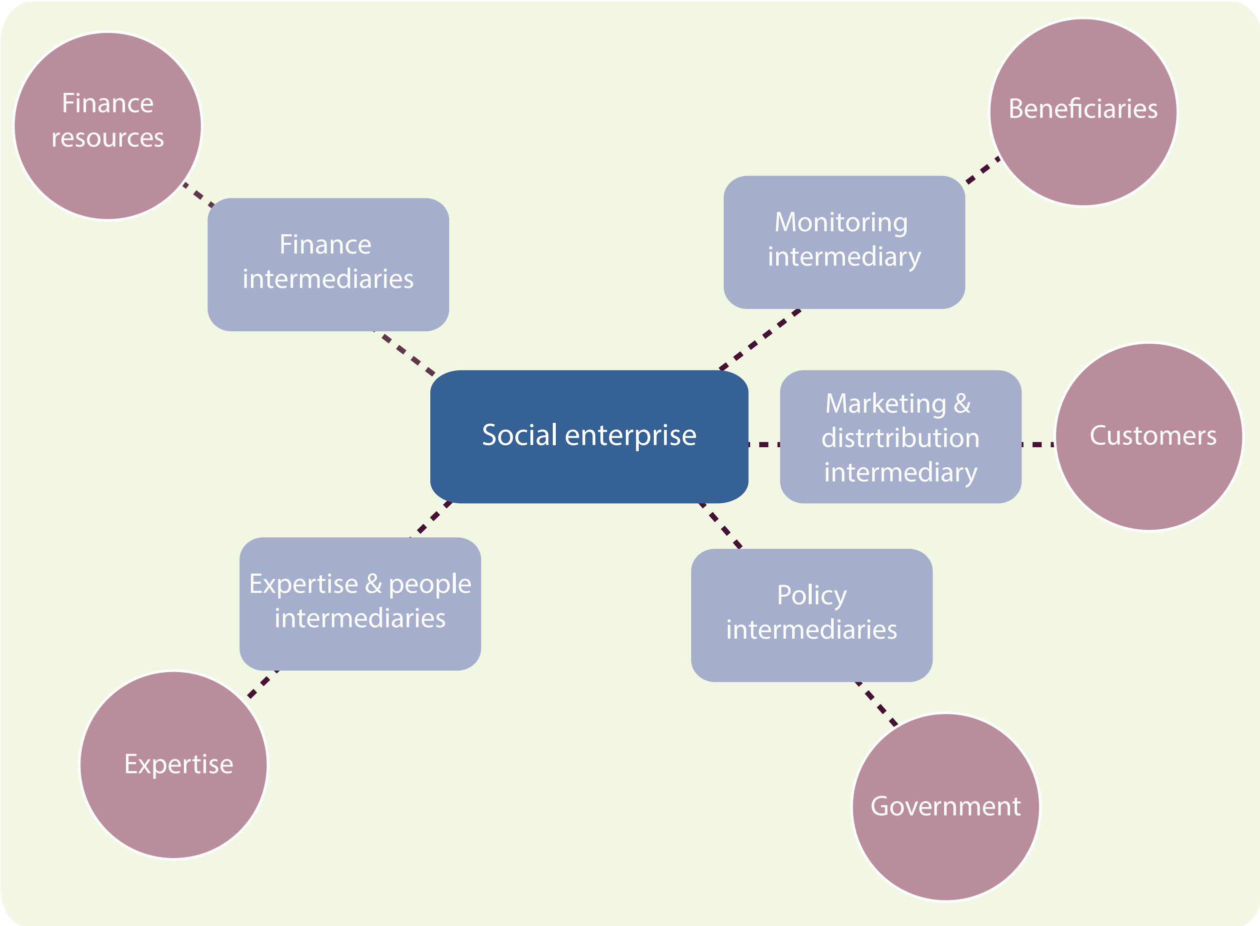
From what we have covered above, we can summarise that the objectives of non-financial support are fundamentally to:

- Generate a constant flow of investible social enterprises (pipeline)

43 ClearlySo (2015a)
44 ClearlySo (2015b)
45 Social Enterprise Day (2014)
46 Clearly Social Angels (2015)

Figure 14. The role of intermediaries

Source: Adapted from Shanmugaligam et al. (2011)



- Build the capacity of social enterprises
- Mould, protect and increase the effectiveness of the investments

Capacity building and pipeline generation are crucial at all levels, not only in the early stages. Yet most support organisations focus on early stage, because the typical menu of non-financial support consists of 1) business strategy support, 2) access to networks and contacts and 3) specific resources and services.[47] 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, but it also means opportunities to meet peers. And, finally, specific services include media exposure, impact measurement or various learning resources and tools.

The topics covered 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, communication and PR, financial management and investments, governance, and social impact management. Your assessment of the market (Who provides what type of support?) and the closer assessment of your targeted social enterprises should help you select the most relevant topics and methods to mix the best non-financial support cocktail.

47 Longair and Tora, supported by UnLtd (2015)

Figure 15. Non-financial support cocktail

4.4.4. 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 investees 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 missing 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's necessary for you to demonstrate a social business model.

Support organisations, especially incubators and accelerators, usually include seed financing or small funds to cover the cost of capacity building support in their package. If you have decided that funding is 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. Seed funding and capacity building grants 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. Some 77% of the GSEN members offer grants, while only 20% have offered equity. Only 20% do not offer any kind of financial support.

Selecting the recipients may be an automatic decision if your non-financial support programme offers funding to everyone who is accepted, such as with a capacity building grant. However, if it is 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. Decisionmaking in those cases can rest on similar criteria to that 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 non-financial support, you will need to make clear if funding is for the long term or a one-off only 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. Otherwise the model may just be a one-off financial award with capacity building leading up to it, and with only non-financial 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 they do money in the early stages.

4.5. 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. Therefore, your most effective intervention would be as a market builder, focussing 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

Example: Range of demand-side services in the pilot projects

The six EU pilot projects that addressed specifically the demand side of their social investment markets targeted a broad group of social enterprises and included a wide range of services. Some worked with very early stage SEs (0–3 years old) with no fully developed business model and/or little experience with financing instruments other than grants. Others targeted growth-phase SEs that were looking for financing growth or working capital. Few had a sector focus. Services included one-on-one coaching and mentoring, as well as group training, networking events and shared facilities. Some providers focused on the SE's management teams, 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 SEs to receive support in impact measurement: tools, implementation, tips and external pressure that would encourage SEs to do it. An interesting question was the SEs' willingness and ability to pay for the non-financial support. Most projects found that SEs were not able to pay, while others suggested to explore what other 'non-cash' ways exist for supported SEs to 'pay' for the services offered. Success of non-financial support could depend a great deal on the absorption capacity of the recipient SE. One provider suggested that free-of-charge services are better received and incorporated. One support organisation, however, believes that SEs should be charged for up to 25% of the cost of coaching and other services received.

Some providers subjected SEs 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 SEs, had a tailor-made approach to due diligence as well, saying that it would depend on the amount borrowed and the risk this posed.

aspects simultaneously may be especially important if you are looking at a nascent market, where a lot of elements are still missing. Market builders may offer a range of support to social enterprises, but they also want to influence other actors in the ecosystem to do their part and/or to act in cooperation. Social enterprise coalitions or similar formations in a number of countries grew into precisely that role, and once consolidated, they became the advocacy organisation for social enterprises.[48] As a result, national social enterprise strategies are elaborated and they can guide government action and incentives to foster the development of the sector.

It can 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 (trusts and foundations) or the government. If the market builders team up with membership organisations or become one themselves, membership fees may contribute to the resources available to them. Otherwise, quite often they 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 Employment and Social Innovation Programme (EaSI; see Chapter 1) allocated significant amounts of resources for that purpose and for the exchange of good practices between countries.

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. Stakeholder positioning in Chapter 1), partnership and coalition building is the way to go. This is true for complex social investment market strategies as well as for the development of a specific instrument. 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

48 Social Enterprise UK (2015)

Tips: How to convene and maintain partnerships/coalitions

- Once you have identified key players, research them thoroughly, focusing on their motivation and interests in the social investment space (personal and organisational interest), and meet them as early on as you can.

- Find committed champions in each partner organisation who will 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.

- 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.

- Constantly cultivate your partners. Inform them, and involve them in meetings, decisions and public announcements.

- Establish tasks and responsibilities at the start. This does not have to be a contract; a flexible Memorandum of Understanding (MoU) is often enough. There is a danger, however, that, being legally non-binding documents, MoUs will be ignored. It is best if the MoU is signed by the top decision makers (the board or CEO) in the partner organisation and if progress reports are sent to them as well. If issues arise, it is better to deal with them right away, before they grow out of hand.

- Define a specific, attainable goal for the partnership to work towards; this ensures that something is delivered and that momentum can be maintained.

- 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. Commitment of partners 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.

compromise and to diverse interests slowing down the development process.

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 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? Is there 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 (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 with others, 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 be typically 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 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 interests over the short run. While government agencies often want to see funds spent quickly and to bring visible results in the reduction of unemployment of marginalised people, for example, and so 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.

4.6. Other sources of support: European structural funds and national-level public funds

While this guide is intended for private and institutional actors, public funds and European Union sources merit mention because of their importance in many countries 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 target two of the European Structural Funds: the **European Social Fund**, where social innovation–, social enterprise development–, and social investment–related programmes are most relevant. The development of the social investment markets has also been included in the **European Regional Development Fund**, which has more experience and flexibility to handle financial instruments. Not all countries, however, have used these funding facilities to explicitly 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. Key considerations regarding the use of EU structural funds are listed in Figure 16 below.

The offer of national public funds varies a great deal, being practically nil in some countries while being 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 listing the key considerations before you decide to apply for such funding:

- How does the use of public funding affect your independence (in terms of financing mix and politically)?
- 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 it repayable finance? If yes, do you have the source of repayment?
- Are there mission implications if you accept the funding?

Figure 16. Advantages and disadvantages of structural funds money

Advantages

- May be a significant amount for the organisation
- May encourage private partners if EU funds complement their investment
- Could be the only funding for your purpose (pilots, market building)
- May encourage beneficial partnership and consortia
- May lead to good visibiilty
- May be earmarked for social investment

Disadvantages

- High administrative burden/cost
- Usually requires consortium
- Inflexible on purpose and timing
- Short- to medium-term
- Often limited by state-aid or procurement rules
- Requires matching
- May deter private sector partners/co-investors if too cumbersome
- May need additional monitoring and evaluation, e.g. the EU's ex-ante evaluations for financial instruments[49]
- Unlikely to provide for repayable funds (currently)
- May cause cash flow difficulties if disbursement is late

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 be going through a similar assessment to what is recommended for you 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.[50]

In the 2014–2020 programming period, lessons learnt from the 2013–2017 period have been incorporated in the regulations governing the use of the Structural and Investment Funds (ESIF). 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.

49 http://ec.europa.eu/regional_policy/sources/thefunds/fin_inst/pdf/ex_ante_vol1.pdf
50 You can refer to the *Ex-ante assessment methodology for financial instruments in the 2014–2020 programming period – Quick guide*, published by the EU in May 2014; European Commission (2014)

Example: Portuguese Social Investment Taskforce II

The Taskforce was launched in 2014 with the goal to promote the development of social investment in the country. This pilot project had very specific objectives in mind: to produce a final report with recommendations about main policy steps by May 2015. The report outlined a vision of the social investment market in Portugal by 2020 and laid out a roadmap for all relevant stakeholders. One of the more concrete outcomes of the pilot was a pilot instrument, the first social impact bond in Portugal. In order to maintain the interest and engagement of Taskforce members, Labóratorio de Investimento Social and Social Finance UK made sure that the time and resources of each member were spent efficiently. The consortium had a powerful and high-profile member, the Calouste Gulbenkian Foundation, which ensured that the project could count on sufficient attention and buy-in from the participating institutions. The Foundation was also instrumental in funding the social impact bond pilot. External expertise of Social Finance UK ensured the integration of experience from the more advanced UK social investment market. The final report was launched at a high-profile event, the Social Innovation World Forum in Lisbon, which helped raised awareness of the social investment agenda as well as the challenges that lie ahead.

According to the vision, EU Structural Funds 2014–2020 would supply a number of financial structures in the shape of funds (Wholesale Fund for Social Innovation, Outcome Fund, Platform for Capacity Building and Market Creation), which in turn would promote the development of social enterprises through financial and non-financial support. Portugal Inovação Social, as the fund is named, will be endowed with €150m to fulfil its mandate until 2020. As Laboratório de Investimento Social envisages, Portugal Inovação Social will play a crucial role in promoting the development of the embryonic market in Portugal. The fund is actually very well positioned to undertake some of the actions that the Taskforce has recommended, namely, the development of innovative social finance instruments.

Example: New EuSEF in Croatia with financing from public sector investors

Another of the EU pilot projects, in Croatia, was aimed at the establishment of financial instruments and mechanisms for young entrepreneurs who wish to start new social enterprises, as well as for existing small and medium-sized social enterprises. The core idea is to set up a new investment fund with the EUSEF (European Social Entrepreneurship Fund) label and to make investments in the order of €150,000 per social enterprise in the form of loans and equity. Cluster za eko-društvene inovacije i razvoj (CEDRA), the designer and future manager of the fund, targeted public sector finance at home and in the rest of Europe. It is planning to involve the Ministry of Labour, Ministry of Entrepreneurship and two other ministries, all of whom either manage EU Structural Funds or have budgets dedicated to solving social problems that the new Fund is also targeting. CEDRA wants to approach the European Investment Fund as well, which has a €400m facility called the Social Impact Accelerator and could possibly take up to a 50% stake in the new fund. Additional investors could be Croatian municipalities, who could leverage their own programmes with the new fund's support.

Summary questions for Chapter 4

Is there an existing market, or are you starting from scratch?

What is the value added of your non-financial support? How would that complement existing financial and non-financial offers?

What are the key elements that need to be offered?

What segments of social enterprise would you focus on? How will you select who to work with?

How would 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 of the same quality as you grow?

What kind of partners will be suitable for your vision? Are there partners you could work with?

Chapter 5: Pilot your initiative

From blueprint to stages of development

5. Pilot your initiative

a. Developing a non-financial investor	**b. Developing a financial investor**	**c. Operational considerations**	**d. Communicating your services**	**e. Considerations for scaling your model**
• Pricing your service • Sustainability of support organisation		• Internal • External		

Whether you are an investor, an intermediary or a social enterprise, you will have the feeling that more money than ever seems to be flowing into social investment. However, many entrepreneurs still find it difficult to raise capital, particularly at the early stages of growth. Investors can also find it hard to attract co-funders, especially in less developed markets, and intermediaries have to balance their independence and sustainability with client ability to pay. Social enterprises are told that their business is at early stage and too risky for investment, while pioneer funders meet entrepreneurs unconvinced by market demand or an ability to exit smoothly and intermediaries are challenged on the sustainability of their model.

Figure 17. From blueprint to scale

1. Blueprint	2. Validate	3. Prepare	4. Scale
• Understand customer needs • Develop initial proposition • Develop business plan reflective of mission • Develop core systems and prototypes	• Conduct market trials • Test business model assumptions • Refine business model, systems, product or services • Is mission intact?	• Stimulate customer /coinvestor awareness and demand • Are they on a mission? • Demand supply chains up- and downstream • Build organisational capacity to scale up systems, talent and assets	• Move into new geographies and market segments • Invest in talent and assets • Exploit systems and processes • Exploit scale efficiencies • Respond to competitors and to market need • Has there been any mission drift?

Chapter 1 looked at the lifecycle of a business. 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 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.

5.1. Developing a non-financial investor

You have 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. Either way, as you move from blueprint to validation, you are likely to discover that the enterprise(s) you want to work with are not used to paying for advice or support and may not be able to afford it anyway. 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 develop each piece of a value chain, then you are probably going to involve expert advice, which has to be paid for, and you 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 run it raises issues both for the sustainability of the intermediary and for the viability of the market. Some law firms who work closely with social enterprise and investors 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. Because this is done transparently, the 'wealthier' clients accept it without question.

5.1.1. Pricing your service

Traditionally very few grant makers were interested in funding intangible things, such as strengthening enterprise. This has changed, and today both private grant makers and public authorities recognise the value of better skilled, more robust social enterprises. It might 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 align with the wider objects of a charitable foundation. 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 need to charge for your services. As you develop your knowledge of the sector you are working in and of its stakeholders, you may be able to develop commercial relationships with funders, agencies, ministries and CSR companies who will pay for their 'portfolio' enterprises to work with you. As you move to scale, you must have a pricing strategy and know your delivery costs. Your options are:

1. Only support the number of organisations you can afford to support from your own resources. This may mean that you concentrate on one-to-many events or webinars rather than more intensive one-to-one support.
    a. One way to implement this could be to run an awards programme, as discussed in section 4.4.1.
2. As outlined above, be sustainable by always factoring in (and gaining) financial support from funders (e.g. foundations), ministries and others who will pay you either directly or indirectly by funding the social enterprise to attend. 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.
3. 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.

5.2. Developing 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 above, there are some specific issues you will need to think about. You should also read 'Setting up a local social investment fund' in Annex 2.

In developing and validating your blueprint, you will need to take into account specific financial regulations and the extent to which it may shape your fund structure, 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 unaware 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? Reputation is everything. In Chapter 3, we looked at investment strategy and choices of financial instrument. You will 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; some funds do little 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)
- Portfolio risk tolerance, from zero upwards
- Structure of fund and 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.

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 and the development of the market infrastructure. Working with an intermediary can extend a foundation's reach and complement its knowledge and skills. Here are some ways that a foundation could support the development of the infrastructure:

- Pilot new funding ideas, initially with grants, possibly convertible into other instruments (including repayable) as the initiative develops
- Underwrite new approaches to finance.
- Provide the grant (equity) tier in a layered transaction.
- Commission for specific outcomes, i.e. create the demand for certain types of intermediary interventions.
- Provide funding for reviews and learning; be a 'devil's advocate'.
- Exchange ideas and knowledge.
- Introduce and support your grantees in their relationship with the intermediary over the long term.
- Fund support services provided by intermediaries.
- Provide a long-term funding stream to strengthen the intermediary's work, so that you can support the intermediary through the essential change management that will flow from growth.

5.3. Operational considerations of development

Operational considerations are common to financial and non-financial investors. They can be internal 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 that you can turn to in the event that:

- You are more successful than you expected
- Piloting does not support your assumptions sufficiently to sustain a viable business going forward

If the pilot is successful, you have a number of considerations, both internal and external.

5.3.1. Internal considerations

- Talk to the team and keep them informed about what is happening and how it's going. Share success and challenges: they may have a solution you hadn't thought of. What are your own plans, and how do these affect succession planning?
- Ask yourself: Do you need to formalise your management structure and 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 a financial investor, you may require regulatory approval or non-objection to 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 piggy-backed them on 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 investment instruments 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 tell you far more 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 it compatible with your accounting system, or will you be faced with a challenging work-around? 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. In the UK, one fund set up in a surfing town. As a result, it was able to attract skilled co-workers who had lower salary expectations.

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 (your clients) will need to be educated. In your country, lots of people may borrow money for personal reasons, but the same people may never have borrowed in their social enterprise capacity. They may have thought that education finished when they left school. Have you got the resources or the skills to provide this capacity building? Or would you prefer to leave it to others – or at least partner with them so that you can influence the content of the services offered?
- Partnering with networks other financial and non-financial 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 three-year period under EU rules. Similarly, there is a cap on the total amount of investment an investor can make. This is all described in detail in the EU State Aid rules[51] and is often referred to directly in Structural Funds calls for proposals.

51 European Commission (2013)

5.4. Communicating your service transparently

Unless you are very lucky, customers will not find you. You need to communicate not just 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 added value you bring to an initiative, and also how you will know if you are providing something that is needed and which enterprises will be willing to pay for. Impact and performance are considered in more depth in Chapter 6. In everything you say and do, it must be transparent 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, say so. If you do not offer enterprises a right of appeal, say so very clearly. It 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 the team. As we have noted above, communicating with your team and with all your stakeholders is essential. You have a responsibility to share your results and your learnings. Hopefully these will not only build confidence in you, your team and your work among key influencers such as funders, but also help those that follow in your wake.

5.5. Must I go to scale?

If you are successful at a certain level of activity related to investment or support, you are likely to find yourself under pressure to go to scale. You may have decided that it is the obvious next step in delivering your vision, but it 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. 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, social enterprise and the third sector are comprised of cottage enterprises – thousands and thousands of initiatives each operating in a single community, often in isolation of others. This may be appropriate, but in many cases it may represent a substantial loss to society. These are some things to keep in mind:

- What further changes will scale bring? In the example below, Investors in Society had to change its structure to transition from being a social investment fund to a regulated values-based bank.
- Can you increase the number of social enterprises you work with without lowering the quantity 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 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 lifecycle long enough to finance follow-on stages of development? 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 or replicate your model:

- You will be able to spread the impact of your model.
- You may benefit from being part of a larger network where you can share resources and operating procedures.

Example: Investors in Society: Charities Aid Foundation (CAF) Social Investment Fund taking an idea to pilot and, latterly, to scale

In 1992, in response to data that showed that charitable giving was not growing sufficiently 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 by the EC white paper Employment and Competitiveness, 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 to get experience with an unregulated fund to test the idea.

The banks saw no market because in 1993–1994 there was none. CAF had to establish the extent of latent and real appetite to borrow, and it had to establish where the funding would come from. In 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 £500,000 of CAF's money.

The Fund's remit was to meet unmet third sector (including social enterprise) need 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 which 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 five years, the fund grew from £0.5m to £5m; 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 from Bank of England to 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, ten 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 six years for the bank to become profitable, during which time it used up some £8m of capital to meet operating and start-up costs as well as to meet ever-higher regulatory costs.

Throughout the 20 years from research to banking operation, the team challenged themselves continually as to whether they were meeting mission and not distorting the financing of the sector. Some 1000 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 the bank is an impact lender.[52]

52 Source: Charity Bank (2015)

- You can move into more markets. By doing so you may mitigate your current market concentration risks and/or reduce your dependency on political or monopsony[53] risk.
- You can produce greater outcomes, probably with more certainty, at a faster pace.
- Demonstrating impact on a larger scale can help you create greater visibility and attract additional resources.

Checking your assumptions and answering the above questions will help you decide whether you should and are able to go to scale from the 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 worth it to go to scale. Quite often a pilot, which may run for only 1.5 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 make enough organisations interested for your initiative to continue? These are the considerations that Chapter 6 will cover. If you find that the demand is missing, you should seriously consider concluding your pilot and think about what else you can do with your resources.

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

- Bring together a multi-disciplinary team. In this case, seasoned bankers with community development workers, micro-financiers, researchers and activists, who all share the vision.
- Everything takes longer than you expect, especially your first loan.
- 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 do.
- Find space for reflection and team thinking, but also find time for everyone to have fun outside the job.
- 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.
- 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 over-commit. Do outperform.

53 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.)

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 how sustainability will be achieved on the long run?

What are the key risks that affect your pilot?

Do you want to scale your model? If yes, what are your top three considerations when deciding how to do that?

Chapter 6: Assess impact and evaluate

How do you know if your pilot project is successful?

6. Impact and evaluation

a. Impact at investee level	b. Impact at investor/ intermediary level	c. Impact of the investment on the social investment market	d. Challenges in social impact management
Impact management cycle for the SE	Impact management cycle for the portfolio		

This chapter is about 'eating the cake', in other words, how to evaluate the performance of your initiative from the financial and social perspectives. The critical and delicate balance between financial return and social impact is key for social investors, who must see their investees succeed financially as well if they want to be repaid their money.

At this point you will have to go back to your vision and goals, as you will be using them to compare performance against. Your goals and return expectations will 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 the baseline: 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 non-financial support you have used. Also, your due diligence of the social enterprise(s), your potential investees, should have given you their individual baseline. You now know what you are assessing against. The question is 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

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 may 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. You should be able to track these indicators easily if the investee has the basic systems to extract the data from, and you should be able to make timely corrections through business decisions. While this may be enough for a regular investor, a social investor will be looking for other signals. Yes, a social enterprise needs to be financially sustainable to deliver its mission, but you will want to look beyond the numbers at the quality of the income and whether this is reinforcing the enterprise's mission. If the enterprise is being paid by results, then an unsatisfactory social impact could lead to financial issues, as the social enterprise will not get paid by the investor unless outcome indicators are met. It is the 'social value' of its work which makes a social enterprise social, and it is this aspect that we now turn to.

The social impact management cycle

We now focus on social impact management,[54] 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; we will supply a few links and sources at the end of this guide. We will not attempt to describe all the existing methodologies; rather, we will offer a social impact management logic that we believe to be universally relevant for most social investors and that we find to be a very useful starting point. It was developed by EVPA, who created the social impact management cycle based on the experience of venture philanthropy investors. This basic logic was then largely adopted by the Social Impact Taskforce of the European Commission's Expert Group on Social Business (GECES) and recommended for the EaSI programme and the EuSEF regulation. It could be considered the basic logic to approaching social impact. Once you start working through it, you can add variations on measurement methodologies, indicators and impact analysis as you see fit.

This process shows the five key steps in a sequential order, 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 consider when taking management decisions in a social enterprise – and in the management of the particular social investment by the investor and more generally within the investor's work:

Figure 18. The five steps of social impact measurement

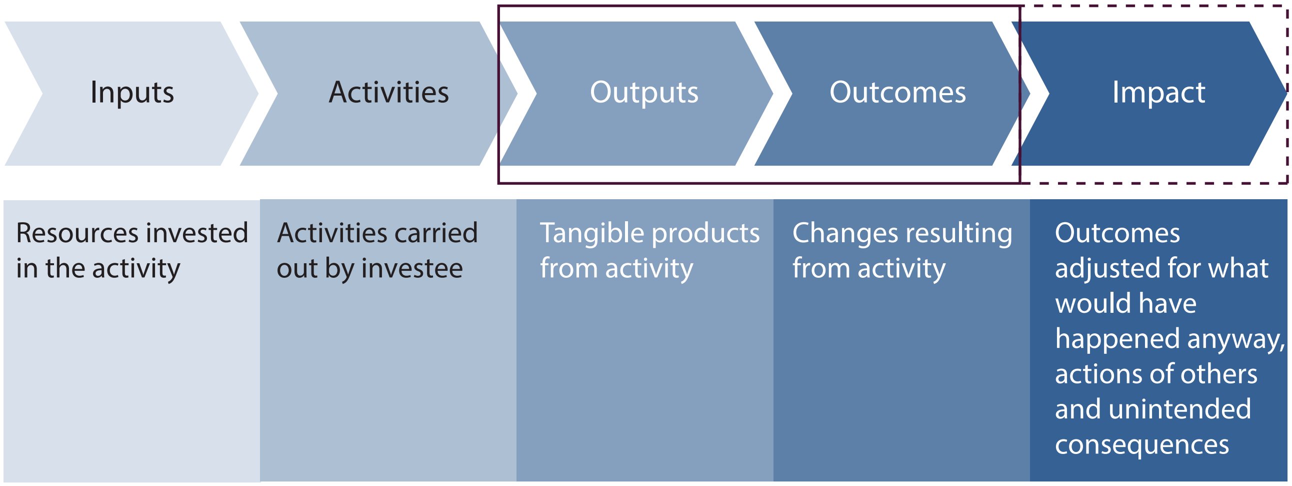
Source: Copyright © European Venture Philanthropy Association. 2013. A Practical Guide to Measuring and Managing Social Impact

1. **Setting objectives:** This should happen at both the investee and investor level. The latter should have already happened when you, the investor, decided what you want to achieve with the investment. The investee, on the other hand, should know what specific impact they want to achieve in their social sector for their beneficiaries.
2. **Stakeholder analysis**: You will need to identify stakeholders who will be impacted by the social enterprise and determine what impact the action will have on them.
3. **Measuring**: In this step you need to 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 the social enterprise should focus on the impact value chain (see Figure 19), what indicators are most relevant and what measurement methodology is feasible. Generally it is most feasible to focus on output and outcome measurement in the short and medium run, while impact measurement may be a follow-up, longer-term exercise that possibly involves research and surveying by third party experts. In Exercise 3 below you can find some guiding questions to help you select the most suitable measurement method and indicators.

54 Throughout we have used social impact as shorthand for social, environmental and/or cultural impact.

Figure 19. The impact value chain

Source: Adapted from European Venture Philanthropy Association (2013)



4. **Verifying and validating**: 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.
5. **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 in the future for the investor. 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.

Social impact management for the investees should ideally already start with the business plan, which should describe the social issue, the target beneficiary group, the proposed solution (including activities and outputs), the expected outcomes/impact and how measuring the outcomes would occur. 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 recent guide *Investing in Innovative Social Ventures*.[55] Such a plan would cover six areas: 1) description of product/service that is supposed to have an impact; 2) target population tightly defined; 3) evaluation plan specifying outcome, indicators measurement, data capture and people responsible; 4) outcome statement describing the effect the product is going to have on someone in the beneficiary group; 5) definition of measurement units and targets for growth; and 6) public benefit statement.

6.2. Impact at the investor/ intermediary level

You can use the impact management cycle to build your own impact management system and measure the social impact of your portfolio: Take your market assessment conclusions (Chapter 1), strategy decisions (Chapter 2) and investment strategy (Chapters 3 and 4) as inputs.

1. **Setting objectives**: The objectives of the investor and investee should be in sync. This might sound like an obvious requirement, but quite often harmonizing 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 theory of change or logic model, are available to think about the objectives.

55 Nesta (2015)

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 Balance Scorecard[56] and provides the basic data for aggregation at the portfolio level. The Balance Scorecard includes goals, targets, baseline and indicators and measures performance of each at regular intervals. NESsT and early stage social enterprises faced all of the above challenges. Therefore NESsT aimed to design a simple-to-use tool that could be expanded in the future. It is a spreadsheet tool that contains individualised indicators of each social enterprise 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. NESsT uses the flagship indicators for aggregation for its diverse portfolio of social enterprises. This is how it is able to interpret and communicate outcome data, such as increase in employment opportunities or improvement of livelihoods, across the portfolio. NESsT also initiated integration with the IRIS database and reports four to five standard indicators that are harmonised with IRIS definitions. The system is always a work in progress, but the NESsT social enterprises all build their impact measurement capacity, are able to better communicate their own outcomes and can thus present more attractive propositions to other funders and investors.

2. **Stakeholder analysis**: Stakeholder assessment and analysis was part of your market assessment, so the information you collected then could now be used and then supplemented with information directly obtained from re-engaging with them.
3. **Measuring**: When selecting methodology and indicators, you should consider first and foremost the interests of your investee social enterprise – 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. 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 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. A classical pitfall of portfolio level impact measurement is over-claiming. Investors are at least one level removed from the direct beneficiaries, so it is difficult for them to decide what happened because of their intervention and what should be attributed to policy change,

56 European Venture Philanthropy Association (n.d.a). The Balanced Scorecard was developed by Professor Robert Kaplan (Harvard Business School) and Dr David Norton in 1992 as a ‘performance management framework that added strategic nonfinancial 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 (2015)
New Profit Inc, based in Boston, MA, in partnership with Professor Kaplan, has adapted the Scorecard for the nonprofit sector by adding the ‘social impact’ perspective.

for example. Investors also often invest in social enterprises that receive funding from other funders too. How can you identify and measure the specific impact that *your* investment made?

4. **Verifying and validating**: 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?

Using the impact data for future investments

Once you have collected and analysed the social impact information, the question is 'And so what?' What will you use it 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 back to your assumptions and basic goals? Are you going to modify your investment strategy? Has your risk appetite been altered?

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 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 evaluation is a very important factor here, 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 an increasing desire and effort to share good practices in non-financial support and data of the social investment markets 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. Even in such cases, it is hard to assess additionality and the possible crowding out effect.

6.4. Challenges in social impact management

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

You can meet 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,[57] whose main objective is to provide funding to organisations to build their impact management capacity. Experience shows that it will take a round or two for investees to get used to the impact measurement tools and to

57 Social Investment Business (2015)

Example: The Investment and Contract Readiness Fund (UK)

A special example of investment readiness programmes is the Investment and Contract Readiness Fund (ICRF) in the UK, funded by the UK government and run by Social Investment Business. ICRF spent £13.2m 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 three years (2012–2015), and an evaluation study was published in October 2015.[58] It reported that the £13.2m spent unlocked £233m in additional resources: £154m in contracts and £79m in investment. That is £18 per every £1 spent by the Fund on support. Analysis shows that organisations were more successful in bidding for contracts than in trying to secure investment for several reasons, which have to do with skills as well as the availability of contract opportunities vs social investors. According to the interviews with beneficiary organisations, a large number of them felt that they would not have obtained the deals without the support. The majority also said that the ICRF support lead 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 are the following:

- Support needs to be flexible and tailor-made.
- Investment readiness can be viewed as a journey, and future funds need to be aware 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 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 the leverage impact of their direct investment in a project existed in unlocking other resources, whether as cornerstone investor or as the missing piece of the jigsaw, that is, something that encouraged others to become social investors. 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. ICRF has now been reconstructed and passed on to Big Lottery to fund, which may result in a widening of its scope. The question is still discussed as to whether this is a good use of government or philanthropic funds, or whether they should be allocated to other uses. 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 investing in investment readiness. At the same time, if it crowds out other 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 report, some of them critical, would be useful inputs into the design of any future contract and/or investment readiness fund.[59]

understand the value added, in addition to seeing it as a reporting tool to you. Dealing with common challenges takes a lot of conversations between the investor and the investee and will usually require dedicated resources, especially on your side. If impact is difficult or impossible to measure by the investee, you will need to decide whether you can invest in building their systems that can capture data or whether you will fund external evaluation of some sort. Some of the challenges can be overcome by 'practice', while others are more far reaching and can probably only be overcome with time, as more experience and data are accumulated. This means that the question whether a model and its results are replicable is difficult to answer 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 information.

58 Ronicle and Fox (2015)
59 Ronicle and Fox (2015)

Table 7. 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
Lack of measurement culture	Agreeing on impact goals/expectations	Short-termism prevents from focusing 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	How to avoid over-claiming
	Lack of skills and know-how	
	Impact is difficult or impossible to measure	
	Impact can be measured only in the very long run, exceeding portfolio/investment lifetime	

Tips: How to overcome the 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 a round or two 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 for the investee and for 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; that would make aggregation easier.
- Avoid over-claiming by building a robust impact model and by using collective impact[60] models when co-investing with others.
- Make sure that the cycle is complete, that there is a feedback loop and that impact data influences activities and decisions going forward.

60 Collective Impact Forum (2015)

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 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. There may be just one or two. You will have to find time to step back and think strategically.

Exercise 3. What do I need to consider when creating a social impact management plan for social investment?

Have you considered	Yes/No
For setting objectives	
What are the key objectives?	
What are the expected outputs and outcomes?	
For stakeholder analysis	
Which stakeholders groups you will engage and analyse?	
How will you capture 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?	
What are your own resources?	
Where will you focus on the impact value chain?	
Will you use standardized vs 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?	
For monitoring and reporting	
What is your monitoring timeframe?	
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?	

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 cycle? If capacity is insufficient, how can you help them to build their capacity?

How much resources 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 into your investment process and strategy?

Chapter 7: Establish learnings and way forward for the market

We hope that this guide has served to give you a flavour of how you can engage in developing the market in social finance and non-financial support measures, whether you are an institution, a company, an organisation or an individual. Such flavours can serve to heighten your awareness of and interest in helping to shape the financial ecosystem in your region, town or more broadly – an awareness that is needed to support a very different type of enterprise, namely, social enterprise, where traditional concepts of financial risk reward are replaced by a multiple bottom line.

The EU pilot initiatives have shown us what is happening in some of the countries of the EU, some very new to such thinking, others with a longer track record of innovation. But they have also cautioned us about how we measure success and about some of the hurdles that still have to be overcome.

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

7.1. Recap of what we have covered in this guide

In 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 when you saw one. We also indicated in these definitions what we believe social finance to mean. We hope that you found sufficient of the basic ingredients 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 focussed on engagement as a non-financial investor. Chapter 5 addressed the stages of development of your initiative, while Chapter 6 helped you think about how you know if your efforts are being successful and how you relate back to your original vision.

There is no tried-and-tested formula or recipe. There are challenges at whatever level you operate, but you can find good examples and practices that can offer learning and that can be copied with variations.

Key messages:

- 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, non-financial support, pilot, impact and evaluation – form a sequence, but they should be steps in a cycle, providing constant feedback and opportunity for recalibration.
- The **process is time consuming**, as it may involve awareness raising, education, culture change and a lot of 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.
- **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.
- **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. It is not only about the interest rate. The choice of financial instrument and complementing non-financial support should correspond to the stage of development of the enterprise and should be flexible. 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 lifecycle finance.

- **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, social investing is not a high-return business.
- **Intermediaries are natural partners to investors: Collaboration with and support for them** also enhances the performance of social enterprises and reduces mission 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 later stage lack of lifecycle finance and support.
- **Pilot your initiative before rolling it out**. This may lengthen the process, but it is worth your while, so you can 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 over the short run**. 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.
- **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 is social enterprise and what, therefore, qualifies for certain types of funding can end up being exclusive rather than inclusive.
- When deciding about your social impact management system, it is important to think through the basic logic; do not focus only on the measurement indicator. **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.**

7.2. Looking forward

- **Enter the individual investors, while pension funds are waiting:** Looking forward, the ecosystem is evolving continually as new entrants enter the market. After the values-based banks and the trusts and foundations, there was an expectation that pension funds would be the next big class of social investor. This has not yet happened; instead, private individuals have begun to increase their presence. This can have 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. 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. Perhaps it is also because individuals can make decisions more quickly. They do not need to seek 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.
- **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 in the USA – but they tend to favour one side rather than the other. So the focus is now coming back to financial instruments, rather than legal structures, which balance the requirements of social enterprise and social investor. One such instrument, known as FLY (flexible low yield) paper, is similar to the way in which Google raised money recently (see Chapter 3). However,

as we have seen 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 top-of-mind 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' is beginning to alter the economics of engagement. The way in which customers want to fulfil financial needs is changing quickly. Investors will expect to see a mirror of engagement in the way they do 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. Through the Internet, they also reach rural or coastal communities as easily as inner-city ones. Starting in 2016, it will be easier for US social investors to invest in European social enterprise start-ups.[61] 'Fintech' also enables the investor to locate in a lower-cost area, where skilled resources may be more readily available. Datasets and award programmes are bringing into the foreground social enterprises capable of going to scale. Cherry-picking these for a digital platform dedicated to social investment can help that enterprise if it is open to numbers 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.

- **Culture of trust and collaboration:** Some of the players are social enterprises. Their language is different to that of the traditional ways of banking and finance. Partly as a result, 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 in order to manage the complexity of returns that are expected.

7.3. Practical recommendations

- **Share experiences and failures:** Create a Trip Advisor–style website for social investment.[62] After concluding a social finance experience, users would go to the platform and answer the question 'What did you think of it?' There would be an obligation upon 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 investment readiness programme, or an enterprise that satisfied investor financial return needs while retaining control of mission.
- **Disseminate research and education across all stakeholders:** There is a huge need for education and research. The social enterprise sector is poorly understood, and there are 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 where management practices, skills and performance and business models are unclear. However, it cannot be generic or of a one-size-fits-all nature. It has to be nuanced, reflecting the diversity of the sector. There needs to be greater dialogue between academics and practitioners, as research findings can make a huge contribution to further development of social outcomes and impact measurement practices. *The Social Investment Market through a Data Lens*[63] is a welcome early contribution, but we must resist the temptation to draw broad conclusions from narrow data sets.

61 Following changes in the US regulatory approach to equity crowdfunding, the UK-based European platform Seedrs will bridge the Atlantic.
62 Alternative Commission on Social Investment (2015)
63 Social Investment Research Council (2015)

- **Make further investments into support organisations and intermediaries:** They 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 the support they need, and more core funding should be provided to intermediaries for building their own sustainability. Intermediaries should be encouraged to better measure and communicate their impact. More collaboration between support organisations and financial investors should make 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.
- **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 and is relevant to the 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 requires repayment long before a social enterprise is generating sufficient cash. But beware of making equity-like structures just too complex to manage.
- **Remember that patience is a virtue:** Moliere 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.

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Glossary of financing instruments

The number of financial instruments designed to address the funding needs of social enterprises and to bridge the gap between social and financial return keeps growing. In essence, there are three types of instruments: gifts, money which is repayable (informal and formal), and money which should be regarded as permanent unless the investment is sold to another investor or a trade buyer. Guarantees are a contingent liability which only become one of these instruments when the organisation is called to pay. The generic types are listed below, 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 mix of the generic categories.

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	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:	3–7 years; up to 25 years for building purchase	If payments are contracted, 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	Reduces enterprise risk to investor; this should be reflected in the loan terms Can be used to unlock down payment to enable you to purchase resources If loan is not repaid or work not done to investor's satisfaction, 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; % of risk; to unlock advance payment; performance risk 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 complied with; can be cheap, but cancellation fees are in addition to cost of loan		

Instrument	Terms		Implications for social enterprise	Implications for investor
Mezzanine capital	Duration:	3–10 years	If interest is contracted, will require predictable cash flow 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:	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 Mission impact? Flexibility of use	Voting rights and possible control Profit participation Limited to zero liquidity /secondary market Long-term High-risk unless model proven Impact first usually
	Payments:	Dividend if in profit		
	Repayment:	No		

Source: Adapted by the authors from Heinecke et al. (2011)

Within these categories are 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 tool of grant makers, foundations, corporations and individuals (donors). These instruments can be unrestricted, so 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. The word restricted in this context means the money has to 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 already have been spent, so there may be nothing to claw back except for the enterprise's reputation. Public authorities and lotteries can impose clawback conditions on larger grants (typically above €150,000). This can make it difficult for an investor to take security.

The amount of documentation will vary from donor to donor and with the nature of the grant. Can be taken straight to income. May need to be shown as a contingent liability if subject to clawback.

Relevance: (HIGH) especially for social enterprise start-ups, innovators and those with charitable status

Feasibility: (HIGH) they work, and they provide the largest amount of social investment; have leverage capability vis-à-vis investment

1.2. Recoverable grant

A less common form of grant. The terms under which the grant can be recovered are agreed upon in advance between the social investor and the recipient, which can be an intermediary as well as a front line enterprise. Designed to focus the recipient on sustainability and 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. Has to be shown as a liability in the recipient's accounts.

Relevance: (MEDIUM) Can help recipient manage initially higher risks before moving to income generation; can reinforce mission focus if donor and recipient are on same page.

Feasibility: (MEDIUM) Not widely used; requires regular monitoring by 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 particular attention to the ultimate objective of achieving societal impact. This is at the heart of the investment; therefore, venture philanthropy funders place particular emphasis on impact measurement and its inclusion in the investment process.

Relevance: (HIGH) Can be essential resource for financial and non-financial support for early-stage enterprises; model is intensive, so one-to-one support has limited availability; little link-up with later-stage finance.

Feasibility: (MEDIUM) Spread within Europe has slowed.

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 you have support and that you have been able to test your thinking with others who can provide challenge and agree the risk parameters.

Documentation varies, but may be no more than a handshake.

Relevance: (HIGH) Especially 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

An extension of family and friends, common in Islamic finance but also, arguably, the way lending used to be done. 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.

Documentation usually involves nothing in writing, but could be a simple IOU or loan note. Unsecured.

Relevance: (MEDIUM) Have a role to play, especially for social enterprises investing in each other. There is limited awareness of this type of financing.

Feasibility: (LOW) Most relevant in Muslim communities or small, tightknit ones. Trust loans are usually held to maturity, as the 'contract' is personal rather than arm's length.

2.3. Program-related investments (PRIs)

Unlike grants, PRIs take the form of low-cost loans, loan guarantees, linked deposits (see below) 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. They have been used extensively in community development and affordable housing. Can be used by the recipient to build debt service track record and financial management skills before moving on to other lender. Can 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 below).

Relevance: (HIGH) Finance is usually available at lower costs and on more flexible terms. Can be mixed with grants and more commercial finance.

Feasibility: (MEDIUM) Is working in some markets but not universal. Requires 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 looking for ideally. 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 NatWest Bank on which they forwent interest so that newer trusts could borrow from the bank.

2.3.2. Shared growth deposits

Canada's largest credit union, VanCity Credit Union, has a shared growth deposit programme in which savers buy RRSP[64]-eligible 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 number of 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) 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 (3–18 months typically), 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 his/her risk. Many commercial lenders seek a floating charge over the enterprise's assets so that they can force you to sell something to repay them if cash flow is not enough. Floating charges can restrict your ability to raise debt elsewhere or for other purposes without the original lender's approval.

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) 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.

64 A registered retirement savings plan, or RRSP, is a tax-privileged savings account.

Feasibility: (MEDIUM) As most social investors do not provide the full range of an enterprise's needs and cannot see, therefore, 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 a number of 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 he/she attaches to those risks and how long the money is needed for, the investor will offer the enterprise x% (x centimes in €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, it comes off its balance sheet and appears on yours until payment is received. If it is with recourse, the borrower has to 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 which can be discounted to provide cash now 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 (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, usually for weeks or a few months and often for less than €1,000 equivalent. The average size varies from region to region and would be higher, less than €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 €25,000.

Documentation varies from provider to provider. Some are social lenders, seeking to reach the poorest they can on affordable terms, while other seek to maximise financial return to investors.

Relevance: (LOW) Still relevant to social entrepreneurs in deprived communities and some Eastern European countries , but generally need is larger than 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.

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 you engage in will reflect your appetite for risk and regions of interest. Investors need to be confident that repayment rates do not mask high levels of refinancing.

2.7. Medium-term loans

After grants, medium-term loans are the largest component of social investment at the moment. They are provided by a range of investors from institutions to individuals but predominantly by values-based banks. A number of social enterprises cannot absorb equity for structural reasons or have an anathema to external capital. Loans are the dominant instrument by default and come in all shapes and sizes. Some examples are provided below.

Typically, a medium-term loan would be from three to seven years, maybe ten years. It may be used to refurbish existing assets, invest in intangible assets such as software or new skills, or invest in new way 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 of 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 from other sources, the investor will lose all or some of their money. In reality, 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 extremis*, 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. As we saw above, the Ford Foundation wanted to make loans to borrowers it had worked with previously as grantees. To take that trust forward, loans were unsecured and documentation consequently short. Secured loan documents can be many pages long and written in legal language.

Relevance: (HIGH) Very relevant to social enterprises, especially in the absence of other instruments.

Feasibility: (HIGH) A relatively straight forward 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

These can be for periods up to 25 years, but because some social enterprises engage in long-term infrastructural development, the term can go out 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 of 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 literally means '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 which would otherwise generate insufficient revenue in the short term to effect repayment.

Documentation 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) 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. Size of need often encourages co-investment and 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 debt. They are usually issued for defined periods of more than one year and can be fixed or variable rate. The bond is the promise to repay the principal along with interest, often evidenced by coupons. In the commercial sector, bonds can be quoted on exchanges, and the price moves to reflect the presumed creditworthiness of the borrower and the yield as the bond approaches its redemption date. Bonds were popular in the 19th and early 20th centuries, when Victorian philanthropists wanted a 5% return on their investments in model urban housing and settlements. In recent times they have reappeared as a way of financing third sector initiatives, including social enterprise. The classical mainstream market meets the very largest needs, such as the Wellcome Trust's €400m 2027 bonds (issued on very low terms, the bond issue was oversubscribed 7.5 times) or bonds issued by social housing landlords or universities.

2.9.1. Retail Charity Bonds

The Retail Charity Bonds platform in the UK allows established charities with strong credit ratings to borrow between €10m and 50m equivalent over five to ten years, although many of the early issues have been for smaller sums. Despite the name, charity bonds are also open 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.

One other possible reason for the development of charity bonds in the UK has been the contemporaneous launch of the Investment and Contract Readiness Fund to reduce the cost of retaining advisors to navigate the process, as well as the emergence of specialist capital advisory firms and a fund to underwrite part of the issue while investor demand develops. Charity bonds are often unsecured, with fewer covenants, more flexible terms and longer duration than bank debt.

2.9.2. Vaccine Bonds

Internationally, there have been Vaccine Bonds, which raise upfront capital to finance vaccination programmes against long-term donor government pledges. 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 European Investment Bank (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 focussed on tackling climate change and are the 'visible part of the iceberg'.

2.9.3. Social impact bonds (SIB)

Although SIBs are also bonds, they are more complex. In times of austerity they have 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 taken on by government previously. Now the government only pays if the pre-agreed targets are met. An 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 to know whether 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 been largely charitable foundations and high-net-worth philanthropists.

A different approach was taken by Perth (Scotland) YMCA with the Living Balance SIB. They recruited 12 'involved' investors whose interests were greater than financial 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 contributed between £5,000 and £50,000, and most were not previous YMCA donors.

Documentation for bigger SIBs can be very complex and can require new skills within all of the parties involved. 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 objective review. They are not 'bonds' but 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[65]

Relevance: (MEDIUM) To date, SIBs have been focussed on third sector organisations, often charities, and intermediaries monitoring the programme. Distinctive social enterprise engagement has been low.

Feasibility: (LOW) SIBs are still in 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.

A variation of the SIB that is being worked up is the **Development Impact Bond, or 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.

3. Semi-repayable finance

3.1. Loan guarantees and loan guarantee funds

These can 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 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. They also provide time during which a lender and an enterprise can get to know each other. There is acknowledged good practice in the provision of guarantees.

- 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 he/she has a specific first risk he/she wants 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 lender directly. There are capped and uncapped 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 lender claims from the various parties and who has responsibility for issues such as validity of the loan contract, 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 termination date to allow for any possible legal or other claims.

Relevance: (HIGH) Can open new sources of funding for social enterprises with low collateral, but costs will be additional to loan cost.

Feasibility: (HIGH) Is happening at the private, institutional and EU levels. There is an opportunity for social investors to co-invest alongside an established intermediary.

3.1.2. Communities of guarantors

Communities of guarantors have been favoured tools for values-based banks, especially those with an anthroposophical background. Gemeinschaftsbank für Leihen und Schenken (GLS) Bank in Germany

65 Instiglio (2015)

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 built through the creation of borrowing and guarantor communities. A group of parents want to build a school, so they form a group, not only to borrow but also to have each parent, according to their means, provide a several guarantee for part of the loan. The parents only guarantee the bit they can afford to. If they move away, it is their responsibility together with the school to find a new guarantor to replace them.

3.1.3. Philanthropic Guarantee Agreement (PGA)

These are pledges by affluent or high-net-worth individuals to make a contribution (usually tax deductible) to a (microfinance) fund if one of its portfolio fails to repay its loan. Losses are shared on a pro-rata basis. Since 2006, MCE has experienced two partial defaults against a guarantee pool of €105m equivalent from 85 guarantors.

3.1.4. Guarantee funds

These funds have been important in international development. Many social entrepreneurs, especially where banking markets are not well diversified, are excluded from the bank system. A guarantee fund acts as a bridge between the entrepreneur and the local financial sector. By way of example, the International Guarantee Fund (formerly RAFAD) 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. In turn, the local banks provide credit to local organisations in 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 European Social Fund in Estonia. It guarantees start-up and expansion capital to enterprises less than three years old, alongside free consultancy advice. In its first five years, to 2013, the fund had provided 304 guarantees.

3.1.5. EaSI Guarantee

More recently, the EaSI Guarantee financial instrument has been implemented by the European Investment Fund (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. It enables the intermediary to widen its target market to include enterprises, such as start-ups, that it would not normally finance. The programme runs until 2023. Intermediaries include not only financial institutions but also 'foundations, family offices, social investment funds'[66] authorised to provide loans/guarantees. So, groups of social investors and high-net-worth individuals could benefit collectively from the guarantee in balancing early-stage risks.

Relevance: (HIGH) Can open new sources of funding for social enterprises with low collateral, but costs will be additional to loan cost.

Feasibility: (HIGH) Is happening at the private, institutional and EU levels. There is an opportunity for social investors to co-invest alongside an established intermediary or to use the EaSI financial instrument.

3.2. Quasi-equity

A number of social enterprises cannot issue share capital for legal or structural reasons but also are reluctant to borrow, seeing indebtedness as a root of the financial crisis. Quasi-equity instruments are financial instruments that share characteristics of debt and equity. In mainstream finance, mezzanine capital and risk- and revenue-sharing partnerships are relatively common. For social enterprise, such instruments are only beginning to emerge.

3.2.1. Subordinated debt, subordinated loans, junior debt

Subordinated debt, subordinated loans and junior debt are types of loan that get paid back to investors last, but ahead of equity. Investors have a junior (subordinate) status in relationship 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

66 European Investment Fund (2015)

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. It can be structured in a number of ways, including first out, where the subordinated debt is paid out first once the senior lender is comfortable with the loan ratios. It may carry an interest-free period. It is often viewed as similar to 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, it is 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, convertible debt

There are two different circumstances in which the loan or bond may be converted into equity. First and foremost, it is a loan that has to be repaid. However, in one circumstance, because the lender is willing to vary the loan terms in the borrower's favour, the borrower gives the lender rights to exchange its creditor position for an ownership in the enterprise at a later date. It another, more challenging circumstance, a loan or bond is converted into equity either because the borrower's regulator requires the intermediary to bolster its capital or upon the occurrence of a future funding round. It is particularly useful 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. The borrower is responsible for the loan repayment and whatever interest is payable – the revenue participation flows from an agreed percentage of revenue. The loan gets capital into the enterprise without affecting ownership, goals or mission, while the investor is properly compensated for the risks involved. Some revenue participation agreements are at total risk insofar as there is no floor interest rate. They can be used by social enterprises with mutual or other non-shareholding status. The money is 'patient' and the risk-reward is shared. However, investors view them as risky and may want higher returns by way of compensation. Track record is often a pre-condition, 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 two-year capital holiday in return for paying a levy on turnover from the end of the second year.

3.2.5. The social loan

The social loan offers debt investors variable payments linked to the enterprise's turnover above an agreed base level with an upper cap.

3.2.6. Royalty financing

A further variation is royalty financing, where the investor takes a stake in a product or service and has to be paid a percentage of the surplus in return for its investment.

3.2.7. Surplus share

This refers to an agreed percentage of profits (surplus) from certain activities, which, if achieved, are paid to the investor.

3.3 Mezzanine debt capital

Generally, this refers to that layer of financing between senior debt and equity, filling the gap between the two. It can take the form of convertible debt, senior subordinated debt or private mezzanine securities, 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. Enterprises need to be cash flow positive. When used in conjunction with senior debt, it reduces the amount of equity required. Traditional mezzanine investors are hold-to-maturity investors, generally focused on cash flow lending.

There are loans where 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 zero 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 local regulatory issues, there should be no issues. However,

advisors have often made mezzanine debt capital 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 with structures more complex than most social enterprises need or understand. To many social enterprises, hybrid may simply mean a structure that brings together in one place a grant, a loan and some form of equity. A challenge for social enterprises and investors has been the inability to have 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 structures that use a series of contracts and agreements to combine one or more independent business 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. They seek to combine profit (for the investor) and mission (for the social enterprise).

4. Equity

Equity can be one of the best instruments for start-ups. However, it can be expensive in respect of control and mission. There is both internal and external equity.

4.1. Internal equity

Starting an enterprise with just your own money is known as **boot-strapping**. Internal equity comes from within the enterprise and is therefore not subject to dilution or possible mission drift. **Historic surpluses** can be used to invest in new ideas, market research for a new market, etc. One cooperative set up a **trust fund** into which it paid a 5% withholding it applied to all goods and services bought from members. The trust money was used as equity to secure loans. When the loans were repaid, the members could have their retentions released or reinvested. The entrepreneur may also wish to set up an option pool for staff colleagues, 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 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 size of investment. Very few social enterprise shares are quoted on exchanges or traded. Private equity investors may therefore look for a trade sale as their preferred exit route.

When deciding whether to go for equity, there are a number of 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
- Does the investor just bring money?
- Amount of profit participation the investor expects and over what time horizon
- Does the investor have an exit strategy?
- What does this do to 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 may 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 creep.

As with debt, there are other types of equity.

4.2.1. Depository receipts

Social enterprises can protect themselves and their mission by having a foundation own all the issued shares but still wish to introduce non-voting capital. They can do this by issuing **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. Average annual return over the past five years has been 4.8%. 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.

4.2.2. Cooperative shares

Cooperative societies are run for the mutual benefit of members who use its services. There is open membership. Recently, the UK regulator, the Financial Conduct Authority, has permitted cooperatives to have investor members who are not otherwise users of the coop's services. A cooperative can pay interest on member share capital as well as a share of any surplus (dividend).

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 the members. Although it has the power to pay interest on members' share capital it cannot distribute surpluses to members in the form of dividends. It can opt to have a statutory asset lock, which is not available to cooperatives. 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 has to develop a sound business case. It then has to win the support of the community and establish appropriate governance structures and draft a share offer document. Although there are community share initiatives in the wider EU, the UK is recognised as the market leader. The Community Shares Unit (CSU) and the financial regulator are working together to recognise and promote good practice through a Standard Mark. The CSU has published the Community Shares Handbook.[67] The Community Shares Company advises initiatives. A growing number of share issues are now raised through crowdfunding platforms. The cooperative community shares fund can also help initiatives and underwrite a share issue. This is useful where local social investors may wish to pay for their shares in monthly instalments.

Relevance: (HIGH) The challenges around mission and control notwithstanding, equity is capital at risk.

Feasibility: (HIGH) There are different types of equity for different structures.

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67 Community Shares (2015)

Glossary of other terms

Social investment and enterprise are not immune from the use of jargon, words, acronyms and terms 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 Clearly So for much of the source material.

A

Angel investor, 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. It refers to an investor's desire for or degree of openness to something. To have an appetite for risk is to be open to taking more risk. To have appetite within the portfolio is to indicate a willingness to increase certain investment types.

B

Balanced Scorecard

The Balanced Scorecard was developed by Professor Robert Kaplan (Harvard Business School) and Dr David Norton in 1992 as a 'performance management framework that added strategic nonfinancial 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.[68] New Profit Inc., in partnership with Professor Kaplan, has adapted the Balanced Scorecard for the third sector by adding the 'social impact' perspective.[69]

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 Pyramid (BoP)

An economic term referring to the largest but poorest socio-economic group, which in global terms refers to the 2.5 billion people who live on less than US$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.

Base of pyramid entrepreneur (BoPreneur)

This is a catchy term for a social entrepreneur who creates a new for-profit business with the mission of addressing a social and/or environmental problem and stimulating the economy at the base of the pyramid.

Below-market return

Level of return on investment which is lower than the average level of return offered by the financial market, for an investment with the same risk profile.

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 – all that investors (whether market-rate, charitable or some mix of the two)

68 Balanced Scorecard Institute (2015)
69 New Profit (2015)

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'.[70]

Boot-strapping

A situation where 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,[71] this 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 in that period 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, at the moment it remains aspirational rather than delivered.

Business plan, Business model

Document which describes an organisation's goals and the operating model and financial resources which will be used in order to reach them.

C

Capacity-building, Organizational development

Approach aimed at strengthening organisations in order to increase their overall performance by developing skills or improving structures and processes. (See also **Investment readiness**)

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.

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 philosophically the same as legally designated benefit corporations but have a few important differences. The B Corp certification is not conferred by the state, but also by B Lab, a US nonprofit organization that promotes the power of business to solve social and environmental problems. B Lab certifies companies the same way TransFair certifies Fair Trade coffee. Certified B Corporations earn their designation by meeting a high standard of overall social and environmental performance. As a result, Certified B Corps have access to a portfolio of services and support from B Lab that benefit corporations do not have. Unannounced audits are done on about 10% of all certified B Corps every year. B Corps were launched in Europe in 2015 and include Charity Bank and Triodos Bank.

Charity, charitable organisation

A charitable organization is a type of non-profit organization (NPO). It differs from other types of NPOs in that it centers 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).[72]

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. grant-makers or individuals), alongside a venture philanthropy organisation. In 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 grant maker or other mix of different risk takers.

70 Blended Value (2015)
71 Overholser (2010)
72 https://en.wikipedia.org/wiki/Charitable_organization

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.

Community development finance institution (CDFI)

Often refers to social enterprises themselves, but may be set up by local government or a mix of the two. Aims to offer affordable finance and advice to unbanked social enterprises, civil society organisations and SMEs, as well as to low-income households and individuals excluded from the financial system. (See also **Social investment finance intermediary**.)

Community interest company (CIC)

A CIC is a legal form limited by shares or guarantee, set up for impact-oriented organisations that are specifically described as legally constructed social enterprises. The key features 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. Currently in UK, the model could be legislated more widely.

Community shares

Restricted to cooperatives and community benefit societies, they are shares in enterprises serving a community purpose and are usually bought by the community themselves. They are usually redeemable, are of fixed term and carry a low interest rate or income which may be supplemented by in-kind benefits.

Company limited by guarantee

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 which are not directly related to the level of activity, by opposition to project or programme costs.

Corpus

The corpus is the original gift and ongoing principal that form the asset base from which a foundation or fund operates.

Corporate social responsibility (CSR)

CSR is a form of corporate self-regulation that is integrated into the business model and takes into account 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 use 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.

Crowdfunding

Funding that pools often small contributions from lots of individual investors via an online platform. It can be donations and/or in-kind rewards or it can be debt and equity. The latter two are regulated.

D

Deal flow, Deal pipeline

Deal flow refers to the number and/or rate of new proposals presented to the investor. 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 her/his resources.

Debentures/Convertible debentures

These are 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. By 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. Usually, debt is 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 one year. Long-term debt is repaid over a longer period. (See also **Loan**.)

Depository receipts

Sometimes also known as ADRs in acknowledgement of the fact that they have been used actively in the USA since the 1920s. In the context referred to in this guide, they 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. They are issued on behalf of the enterprise by the entity, usually a foundation, that owns the voting shares. They are entitled to dividends but are not quoted on any exchange. Instead the enterprise tries to match willing buyers and sellers.

Development impact bonds (DIBs)

DIBs are structured similarly to social impact bonds but focus on achieving international development rather than publicly funded domestic outcomes. (See also **Social impact bonds**.)

Dilution

The reduction in percentage ownership of an enterprise that investors 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 the second bottom line, a measure of positive social impact.

Due diligence

Due diligence is the process where an organisation's or company's strengths and weaknesses are assessed in detail by a potential investor with a view to investment.

E

Environmental social and corporate governance (ESG)

ESG is a catch-all phrase 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 investment 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, including 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. There is a separate Glossary of the financing instruments, above.

Financial sustainability

Financial sustainability for a social enterprise 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.

First loss tranche, First risk layer, 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, Equitable charge

A floating charge is an equitable 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. It is convertible into a fixed charge, at which point the charge attaches to specific assets. Many lenders will ask for a floating charge. A floating charge can 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. An equitable charge does not give a creditor ownership or possession rights, but it gives the investor the right to go to court to recover the loan.

Foundation

Public-benefit foundations are asset-based and purpose-driven. They have no members or shareholders and are separately constituted third sector bodies. Foundations focus on areas ranging from the environment, social services, health and education, to science, research, 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 such activities through grant making, operating programmes or programme-related investing (PRIs). See Glossary of financing instruments, above.

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 be happy to take higher risk.

Fund

A fund is a vehicle created to enable pooled investment by a number of investors and which is usually managed by a dedicated organization. It can offer one or more financial instruments. See Glossary of financing instruments, above.

G

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 that some investors do use 'returnable grants' from time to time. This 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.

Grant maker

Grant makers include institutions, public charities, private foundations, individuals and giving circles that award money or subsidies to organisations or individuals. Generally known as foundations in continental Europe, grant makers also include certain types of trusts in the United Kingdom.

H

High-engagement funding

High-engagement funding, as defined in a seminal article by Letts and Ryan,[73] 'is first and foremost a performance centred strategy where alignment, reliable money and strategic coaching are used together to convert a grant financing relationship 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

73 Letts and Ryan (2003)

their social goals.' High-engagement funding has many of the features of venture philanthropy.

I

Impact investing, 3D investing

Impact investing is 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 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. Impact investors currently seek higher financial returns.

Industrial and provident societies, credit unions, community benefit societies, cooperatives, 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 will have a regulator who 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 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, where innovative hybrids became a popular method of hybrid financing. Innovative hybrids took a debt instrument and blended it with derivatives, like a swap or option, whose financial returns were associated with a number of common economic variables. They are used classically to handle risk of all types. A challenge for social enterprises and investors has been the inability to have 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 which have strong social impact drivers. This has led to innovative but often complex structures that use a series of contracts and agreements to combine one or more independent business 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. They seek to combine profit (for the investor) and mission (for the social enterprise).

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 investment phase is the period between the investment of monies into the project, organisation or social entrepreneur, and the exit. The **investment proposal** is 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

Investment readiness work helps enterprises to get ready to take on debt, equity or other kinds of investment. For those that do not move onto investment, investment readiness work may have helped them understand money better and prepare business and financial models with greater confidence. Investment readiness can be provided by support organisations or by investors.

K

Key performance indicators

These are financial and non-financial, quantifiable metrics used to measure the progress against the objectives of the project, organisation or company. (See also **Investment phase**.)

L

Layering

Many investment proposals embody different levels of risk that may appeal to different categories of investor. Layering is the process of structuring a transaction or series of transactions that correspond to the risks.

Lead investor

The investor who helps the entrepreneur get all the other investors involved. The lead can be the first, largest, most influential, or just most proactive investor. They will often take the lead on doing due diligence and negotiating the valuation.

Leverage, Gearing

Also known as gearing, leverage it is the measurement of how much extra investment (or other resources, such as public money) has been brought into an enterprise as a result of an initial investment. Technically it is also a measure which 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), here social enterprises.

Limited company (Ltd.), Public limited company (PLC)

A limited company has shareholders as well as company directors, and can take on equity or debt investment. A public limited company (PLC) is traded publicly on a market or stock exchange.

Loan

A loan is a sum of money lent at interest, where financial return is sought. (It is common for venture philanthropy organisations and foundations to provide loans at reduced interest rates or to have other 'softer' features, e.g. on repayment terms.) (See also **Debt**.)

Long-term investment

A long-term investment is made over a period of five years or more. **Mezzanine financing** is a hybrid of debt and equity financing, usually used to fund the expansion stage of an organisation. Although it is similar to debt capital, it is normally treated like equity on the organisation's balance sheet. (See also **Short-term investment**.)

Low-profit limited liability company (L3C)

L3C is a legal structure for businesses in the United States 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. L3Cs are taxed. They operate with a stated goal of achieving social improvement, with profit as a secondary goal.

M

Market failure

Market failure is where the market is not interested in providing or does not supply goods or services into a marketplace. The market, usually private business, sees no or little profit in it or otherwise considers the risks too high for the return. Market failure happens more often in excluded, remote or marginalised communities.

N

Non-financial services, 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. Nonfinancial support is offered by volunteers, staff, donors or third party consultants.

O

Outcomes

Outcomes are the ultimate changes 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.

Outputs

Outputs are results that a company, non-profit or project manager can directly assess or measure.

Overdraft, Line of credit

Overdraft is a popular form of working capital finance. It is a line of credit agreed by the bank and the enterprise, which 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.

P

Patient capital

This is 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.

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' portfolio, to distinguish between the organisations with which the investor is actively involved. Usually, however, all portfolio organisations are included in the greater network of the investor.

Portfolio manager, Investment manager

A portfolio manager 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 pre-investment stage is the process during which the investor examines the operations and leadership of the project or organisation with a view towards 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 if it is likely to get what it thinks it is paying for.

Private equity

Ownership in a firm which is not publicly traded and which usually involves a hands-on approach and a long-term commitment for the investors.

Profit and loss statement (P&L), 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, and 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 Agreement (RPA) in the Glossary of financial instruments.)

R

Receivables financing

This is an asset financing arrangement where a company uses its receivables – money owed by customers, as collateral for a loan. Social enterprises suffer from late payment from purchasers, meaning they can have money tied up which they cannot access. The enterprise receives an amount equal to a percentage of the receivables pledged. If it is done by the enterprise selling the invoice and the recovery rights in the event of non-payment, it is an asset purchase or without recourse financing. Factoring is different in that the credit control function is outsourced to the factor, who discloses to the purchaser that the money should now be paid to them.

Responsible investing (Environmental, Social and Governance, ESG investing)

Is differentiated from impact investing in that it tends to screen portfolios to remove negative impacts. (See also **Impact investing**.)

Return on investment (ROI)

The return on investment (ROI) is the profit or loss resulting from an investment. This is usually expressed as an annual percentage return. (See also **Social return on investment**.)

S

Scaling up

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 (new products/services target groups or locations), partnerships (networks, branding, licensing, social franchise, joint venture) and knowledge and know-how dissemination (open source).

Seed financing

Seed financing is 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 which 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 to 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 can then be referred to if there is any mission drift.

Short-term investment

A short-term investment is an investment made over a one-year period less, or an investment that matures in one year or less. (See also **Long-term investment**.)

Social capital market , Social investment market

Financial market dedicated to social investment which aims at systematizing and facilitating social capital allocation.

Social enterprise

See text, Chapter 1.

Social entrepreneur

The term social entrepreneur is 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'.[74] Social entrepreneurs may be sole traders or work in environments that are not necessarily recognisable as social enterprises.

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'.[75] See also text, Chapter 1.

Social impact

The social benefit derived from the activities of a social purpose organisation. (See also **Social purpose organisation**.)

Social impact bond (SIB)

See Glossary of financial instruments, above.

Social indicators

Key performance indicators specifically adapted to measuring the performance of social purpose organisations. (See also **Social impact, Social return on investment, Balanced Scorecard**.)

Social investment finance intermediary (SIFI)

An organisation that provides, facilitates or structures financial investments for social sector organisations and/or provides investment-focussed business support to social sector organisations.[76] (See **Community development finance intermediary**.)

Social purpose organisation (SPO)

The acronym SPO 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

74 Schwab Foundation for Social Entrepreneurship (2011)
75 Emerson et al. (2007)
76 Big Society Capital (n.d.)

varies enormously across countries and jurisdictions and is therefore far from precise. The following types of organisation will fall under the banner of SPOs. (See also **Social impact, Third sector organisations**.)

- Charity, non-profit, not for profit, foundation, association, company limited by guarantee (having no trading activities, or where trading is of marginal importance)
- Social enterprise, community interest company (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 social enterprise, there are several different models.
- Socially driven business – profit-distributing businesses but with clear and stated social objectives.

Socially responsible investing (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 refers to proactive practices, such as impact investing, shareholder advocacy and community investing. Socially responsible investments encourage corporate practices that promote environmental stewardship, consumer protection, human rights and diversity. They 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.

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 social return on investment was pioneered in the 1990s by a US venture fund called Roberts Enterprise Development Fund and has since caught on elsewhere.

Social venture capital

Social venture capital is an enterprise approach to tackling social problems through investment to support the creation and expansion of commercially sustainable enterprises in order to maximise social and financial returns. In developing countries, this approach is used to create jobs and empower the poor.

Spin-outs

In many countries the public sector is shrinking. Spin-outs are companies set up by experts who want to take a solution developed within their sector, e.g. a university or a health service, and take it to scale. Some spin-outs are done for cosmetic reasons 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 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.

Sweat equity

This is 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.

T

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. It usually covers things like 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 (TSO)

Is a term used to describe the range of organisations that are neither public nor private sector. TSOs are also known as NGOs, nonprofit organisations, civil society organisations or social purpose organisations. 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.

Triple bottom line (TBL)[77]

Coined by John Elkington, the term refers to the three prongs of financial, social and environmental accountability. While businesses of the past only had to be accountable for their financial performance, today's enterprises are increasingly pressed to demonstrate concern for three bottom lines: financial, people/communities and the environment.

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**.)

V

Values-based bank

Banks and banking cooperatives with a shared mission to use finance to deliver sustainable economic, social and environmental development. Their Global Alliance for Banking on Values (GABV) comprises 27 financial institutions operating in countries across Asia, Africa, Australia, Latin America, North America and Europe; serving 20 million customers; holding up to US$100b of combined assets under management; and powered by a network of 30,000 co-workers.[78]

Venture philanthropist

A venture philanthropist is engaged in venture philanthropy, either as an individual or in conjunction with a venture philanthropy organisation.

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 three to five years, then exiting when organisations are financially or operationally sustainable
- **Nonfinancial 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 outcome, achievement of milestone and financial accountability and transparency

Voluntary income

Voluntary income is defined in UK accounting practice, UK GAAP, and covers 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.

W

Warrants

Warrants and options are similar in that they 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

Finance used to manage the timing differences between spending money and receiving it.

77 Elkington (1997)
78 http://www.gabv.org/about-us

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 reduce barriers encountered in accessing social enterprise finance in both the demand and supply sides of the market.

Following the call for proposals, a total of 21 pilot projects in 15 EU countries (shown below) were chosen for funding, which focused on four Strands:

Strand A: Establishment of social finance partnerships aims to address the supply aspect of social finance, notably in those EU countries where the market for social finance is not yet developed.

Strand B: Establishment of social finance instruments and mechanisms also tackles the supply side in countries where social finance is growing. It aims to develop instruments to foster and formalise collaboration.

Strand C: Establishment of collaborative funding models for social enterprises focuses on EU countries where actors are operating in the supply side of the social finance market on an isolated, individual basis, aiming to foster market integration in these countries.

Strand D: Development of investment readiness support for social enterprises tackles the demand side of the social finance market, with a view to strengthening the 'investment readiness' of social finance.

Title: Social Entrepreneurship Supporting Network, SES Net **Details:** The aim of this project is the establishment of a social finance local partnership in Karditsa, Greece. The project will focus on replication and scalability into other regions of the country, potentially leading to a sound national social finance instrument. http://www.sesnet.eu/index.php/en/		
Strand: A	**Country**: Greece	**Main Applicant**: ANKA
Title: SocFin - Building partnerships for social finance in the Lombardia region **Details:** The main objective of the project is to support the development of financial instruments that benefit social enterprises and innovation in the Lombardy region. The project aims to complement the existing facilities, while developing both the financial tools and the investment market by raising awareness and building consensus at a local and EU level. http://milan.impacthub.net/		
Strand: A	**Country**: Italy	**Main Applicant**: The Hub srl
Title: Alliance for Social Impact Investment **Details:** The consortium aims to identify and establish a partnership between investors and other key stakeholders in order to develop a social finance platform that leverages young social businesses in Portugal. http://tese.trtcode.com/		
Strand: A	**Country**: Portugal	**Main Applicant**: TESE
Title: Preparing the ground for a social investment market in Denmark **Details:** The objectives of this project are to explore and identify social financial instruments best suited for a small open economy. It aims to outline specific models, determine how to ensure a favourable environment for attracting finance for Danish social entrepreneurs and identify possible investors and intermediaries with a view to develop a social investment market. http://socialvirksomhed.dk/en		
Strand: A	**Country**: Denmark	**Main Applicant**: National Board of Social Services

Title: Fostering the development of a new financial instrument for social ventures in Germany **Details:** This project's main objective is to establish social finance partnership for a new financial instrument, addressing the substantial financing gap for social ventures that are seeking to raise capital for growth in Germany, particularly those started by young entrepreneurs. http://impactinmotion.com/		
Strand: A	**Country**: Germany	**Main Applicant**: Impact in Motion GmbH
Title: Catalysing a social investment market in Portugal **Details:** This action proposes the creation of a Social Investment Taskforce in Portugal. The Taskforce's final output presents recommendations and action plans for different players to implement in order to prepare for the creation of a social investment market in Portugal. http://www.investimentosocial.pt/		
Strand: A	**Country**: Portugal	**Main Applicant**: Labóratorio de Investimento Social
Title: Establishment and promotion of direct financing instruments in social enterprises **Details:** This project is aimed at promoting the implementation of association bonds and cooperatives shares, accredited by the National Council of Cooperation. https://www.financite.be/fr		
Strand: B	**Country**: Belgium	**Main Applicant**: Réseau Financité
Title: Strategy for the operations of the Social Entrepreneurship Fund for Central and Eastern Europe (CEE) - Impact fund (EuSEF) **Details:** The main objective of this project is to undertake the necessary preparatory activities in order to set up an innovative financial instrument in the form of a EUSEF that provides finance to social enterprises. https://tise.pl/		
Strand: B	**Country**: Poland	**Main Applicant**: TISE
Title: Social venture incubator **Details:** The overall goal of this project is to develop a social venture incubator (SVI) in the area of social business, dedicated to the provision of consultancy and financial support to innovative ventures in various target areas. http://makeacube.com/		
Strand: B	**Country**: Italy	**Main Applicant**: Make a Cube3
Title: First structured financial instrument for social entrepreneurship in Croatia **Details:** The objective of this scheme is the establishment of financial mechanisms for young entrepreneurs aiming to start new social enterprises in Croatia, as well as for existing small and medium social enterprises. Implementation of a new financial instrument is envisioned through the establishment of a new investment fund with the EuSEF label. http://www.cedra.hr/hr/o-nama/cluster		
Strand: B	**Country**: Croatia	**Main Applicant**: Cluster za eko-društveni razvoj i inovacije
Title: Creating 'hybrid financing' packages for social enterprises, including different types of donors, investors and integration of a range of financial instruments **Details:** This project seeks to demonstrate the feasibility and benefits of an orchestrated approach to providing social finance by different types of donors, investors and public authorities. It intends to mobilise and commit potential investors to co-operate with a view to finding innovative approaches to financing social enterprises. http://www.fa-se.eu/		
Strand: C	**Country**: Germany	**Main Applicant**: FASE
Title: Preparatory action for the launch of the Social Impact Bond in Estonia (SIB Estonia 2015) **Details:** The main objective of the project is to set up and prepare the successful launch of the first social impact bond in Estonia in 2015. http://www.heategu.ee/		
Strand: C	**Country**: Estonia	**Main Applicant**: Good Deed Foundation
Title: Supporting the demand and supply side of the market for social enterprise finance **Details:** The aim of this initiative is to fill missing components in the ecosystem for social enterprises. These gaps affect the ability of the ecosystem to serve the largest number of social enterprises possible, the ease and speed with which entrepreneurs can navigate the ecosystem, and the total amount and matching of financing for social enterprises at all stages of early growth. http://www.i-propeller.com/		
Strand: C	**Country**: Belgium	**Main Applicant**: i-propeller
Title: European Ethical Financial Ecosystem for local partnerships supporting new Social Enterprises (3E4SE Funds) **Details:** This project aims to establish and test a strategy for cooperation between public, ethical, alternative or cooperative funds for the development of specific local/regional financial tools supporting emerging social enterprises led by young people. http://febea.org/content/sefea-european-ethical-and-alternative-financing-company		
Strand: C	**Country**: Italy / Sweden	**Main Applicant**: SEFEA

Title: Strategic incubation to ensure investment readiness and sustainable social impact **Details**: The goal of the project is to provide long-term incubation support to early-stage social enterprises in Romania and Hungary, helping them prepare for the acquisition of external financing or packages of different types of finance. The project will focus on strengthening the capacities of 18 social enterprises that have already completed business plans and need capacity to build support to develop successful proofs of concept and become 'scaling ready'. http://www.nesst.org/hungary/		
Strand: D	**Country**: Hungary / Romania	**Main Applicant**: NESsT EUROPE
Title: Think Big: social innovation driven by social business and young entrepreneurs **Details**: This project seeks to identify the requirements and conditions of social investors to invest in social businesses, developing a support structure for social businesses and testing the methodology with 15 social entrepreneurs. http://www.kiz.de/		
Strand: D	**Country**: Germany	**Main Applicant**: KIZ
Title: Investment readiness programme **Details**: The primary objective of this service is to help more social entrepreneurs find their way to investors and make sure that their growth ambitions are investor-ready. To do this effectively, Social Enterprise NL will strengthen its own current service portfolio, which now includes a range of thematic master-classes, training events and coaching for individual social entrepreneurs, moving from knowledge exchange to a more intense learning curve. http://social-enterprise.nl/		
Strand: D	**Country**: Netherlands	**Main Applicant**: Social Enterprise NL
Title: Investing in our future **Details**: The main objective of this project will be to build an integrated programme 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 will also provide a hub of shared learning and best practice, and serve as a conduit for business planning support. http://www.socialinvestmentscotland.com/		
Strand: D	**Country**: UK	**Main Applicant**: Social Investment Scotland
Title: Investment readiness for social impact **Details**: This project is aimed at building up a structure for cooperation between experts from the finance sector. These experts will be encouraged to help social start-ups with the development of financial strategies and plans, as well as assisting with access to finance. http://socialimpact.eu/		
Strand: D	**Country**: Germany	**Main Applicant**: Gemeinnützige social impact GmbH
Title: Attracting communities towards social enterprise investment (ACT SOCIAL) **Details**: This project envisages the testing, possibly as a pilot, of a network among the social cooperatives of a specific area - Lombardia (Valcamonica). A financial institution, a University research centre and a cooperative training center will work together in order to achieve better on-field knowledge on the investment side and growth in appeal on the demand side. http://www.actsocial.eu/		
Strand: D	**Country**: Italy	**Main Applicant**: Sol.Co. Camunia s.c.s.c. ONLUS
Title: Social entrepreneurship finance tools and support in Europe **Details**: This project organises several events about social entrepreneurship in order to create a meeting point for social entrepreneurs, investing experts and institutions, helping identify the needs and appropriate tools for finance. Social entrepreneurs who show a keen interest receive an incubation, development and launching program for their business idea. http://www.civesmundi.es/eng/presentacion.php		
Strand: D	**Country**: Spain	**Main Applicant**: Asociación Cultural Ongd Cives Mundi

All of the above links are as of 17 November 2015
Source: RAND Corporation (2015)

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, 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 be set up at different geographic levels. Here we look at local funds. A local fund can offer linkages between local investors and local enterprises. It 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. These vary from those seeking to be entirely independent and to generate revenue from their activities (including allowances for bad or doubtful debts), which will allow them to build a sustainable institution, to those who may prefer to add value to their business through, say, the provision of training and enterprise development work, for which they anticipate receiving revenue support year-to-year. Some 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 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 her or his own background rather than understanding the purpose of the fund. Clarity about who owns the fund and in whose interest is it 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. It can take a long time to get real. Is there a team in place with the right skills? These are: sector knowledge; research and development 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 need to raise not just capital for the fund, but also revenue funding until sufficient loan income flows. Partners need to be identified and courted. Some may be funders. Some may provide loan referrals. 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. Banks rarely make money from this market, so you will need to focus on cost effectiveness and efficiency. Good software systems are available nowadays for back office operations. Alternatively, 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 Euro lent has to be raised. There are a number of ways to raise capital, which are here addressed 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 be set up, capitalised by some funders who see the benefit of underwriting private funds.
- **Pilot lending**
  Start with some 'low-hanging fruit' 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 better not to allow appeals against declined proposals.
- **Marketing**
  Marketing is about finding 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 get real. With clear procedures, paperwork, technical systems, hardware, people and deals, everything is manageable. The detail is processing transaction after transaction and getting it right every time. Expert advice will help you know if you are.
- **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.[79]
- **Action**
  The time to start is now!

Things to remember

- You should 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 have a university or a monastery.
- 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.

79 This note is drawn from Sattar (1999)

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