A Handbook of Private Financing Tools for Social Enterprises

Eurodiaconia

Eurodiaconia is a **dynamic**, Europe wide **community** of organisations founded in the **Christian faith** and working in the tradition of Diaconia, who are committed to a Europe of **solidarity**, **equality** and **justice**. As the **leading network of Diaconia in Europe**, we connect organisations, institutions and churches providing **social and health services and education** on a Christian value base in over 30 European countries.

We bring members together to **share practices**, **impact social policy** and **reflect on Diaconia in Europe today**.

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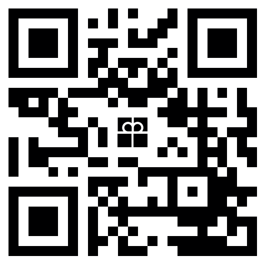

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Foreword

This publication has been commissioned, monitored and steered by Eurodiaconia.
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Introduction

Social impact investing and venture philanthropy are terms that are more and more used, not only in the social entrepreneurship fields, but also in the traditional finance and banking areas.

What do they mean exactly? How can they really help social enterprises?

One of Eurodiaconia's focus areas is to promote social enterprise initiatives among our members to organise their provision of social and health care services. In spite of the growing importance of social enterprise projects among Eurodiaconia members, many of them are faced with challenges in accessing funding sources which are able to finance such projects in an adequate manner. The impact of the crisis and austerity measures have resulted in tighter public budgets and, consequently, diminished public funding opportunities for social enterprises. Moreover, this is happening in a context of increasing demand for social services. In view of this, diaconal providers of social services have turned to private sources of funding as a way to circumvent these shortages.

The increased demand for private sources of funding matches the growing appetite of private investors to invest in social enterprise projects with an expectation of both social and economic return. Private funding brings both opportunities and challenges to not-for-profit organisations as diaconal social enterprises. Regarding the challenges, with an increased involvement of private finance there is a risk of monetisation of service outcomes. This could result in a 'creaming' effect, whereby services for the most vulnerable might be discontinued in favour of projects that lead to higher success rates. Also, private finance or philanthropic organisations may be more ready to support new, small projects, but also often with a focus on groups that may bring positive reputation to them in the eyes of the public.

Eurodiaconia, therefore, wishes to improve the understanding among diaconal social enterprises of which types and instruments of private financing are available to them and to assess which among those could be most useful to fulfil the social mission of social enterprise projects. This need was identified at Eurodiaconia's latest event on Work Integration Social Enterprises (WISE), organised jointly with ENSIE and EASPD in Brussels, 18-19 May 2015. The event was an occasion to showcase WISE projects run by Eurodiaconia members[1] and reflect on ways in which private finance can help to further develop social enterprise projects with an inclusive aim. The goal of this research is to increase our members' knowledge on available options for that purpose.

The economic, financial, social or environmental crisis of the last years has shown that our socio-economic system has shortages. To address its imperfections, social enterprise initiatives have emerged across the world. Their environment being what it is, these organisations still need to find funding sources to reinforce their capital base. So far, the traditional funding tools for social enterprises have been donations, public subsidies or loans, for the organisations that generate financial surplus. Donations and public subsidies avoid the need for repayment (principal and interests) and are therefore much appreciated. Some controls may be conducted in the case of public investment subsidies to ensure their proper use, but few constraints are usually linked with these conventional funding. The traditional loans require the organisation to repay the bank but the terms and conditions can be discussed. The interest rates will vary according to the perceived risk, the amount of the loan and the

1 AAC Shirak Diocese Social-Educational Centre (WCC Armenia Inter-church Round Table Charitable Foundation), Fairhaus (Diakonie Düsseldorf); Pedalen Project (Church City Mission in Noway); Pro Arbeit (Diakonie Deutschland); Renewal Project (Slezská Diakonie);

time period. Whilst these tools are widely used, they have some disadvantages. Subsidies and grants are usually unstable, according to the projects, the period of the year or the global environment. Public funds are often under pressure and therefore cannot support the expansion and innovation policies of organisations. These also spend a lot of energy finding donors and keeping them on track. The loan, for its part, implies paying back interests (which might be low or high, according to the perceived risks) and often require collaterals (assets that work as insurance if the organisation cannot reimburse the loan). They are thus not accessible to all social organisations and many of them are reluctant to use loans.

Previously, private investments were used by traditional investors for traditional companies. However, socially responsible investment (SRI), social impact investing (SII) and venture philanthropy (VP) are on the rise. The last years' crisis raised awareness of the fact that maximizing financial returns only cannot solve global issues. Social impact investment and venture philanthropy are thus an opportunity and have an added value for social enterprises and non-profit organisations. They can strengthen the capital base, in order to support the organisation's expansion and foster innovation. To be sustainable and have the biggest potential impact, the organisations have to use funding tools that support and leverage their balance sheets. Healthy balance sheets will secure their financing and therefore support their programmes and projects within their scope. Creating financial reserves will allow organisations to cope with their general treasury and with future investments. Impact investing and venture philanthropy will therefore strengthen the core structure of the organisations. But what is exactly the difference between both?

Although those concepts have a same goal - social improvement-, their approaches are slightly different. Impact investors are looking for both social and financial return while venture philanthropists bring financial and non-financial support to organisations, regardless of the positive or negative financial return. Some investment tools require the presence of intermediaries to support the setting up of the agreement while others allow investors to invest directly in a social enterprise. It is for example the case for cooperatives, where the members purchase capital shares, which allow the organisation to provide services to meet their members' needs as part of a community. Some of the available tools are very much like traditional tools (equity, quasi-equity, bonds), while others rely much more on citizen and solidarity-based financing (crowdfunding, Social Impact Bonds, etc.).

A wide variety of tools exist, having all advantages and drawbacks. They are also very different in terms of risks for the investors (and therefore the expected returns), of social performance requirements, of relevance given the needs of the organisation, etc. Some tools may be relevant for certain steps while others will be used in combination with others to have a greater impact. The key is to keep in mind the dynamic aspect within the use of these tools. The biggest advantage of private investment tools is the long term impact that they have on the organisation. As most of them are medium or long term tools, they guarantee a sustainable support to the organisation. Also, private investment tools foster innovation and allow the enterprises to scale up their activities. However, globally, these tools are more risky than traditional ones (bank loans, grants and donation, and public subsidies). They should therefore not replace them but be complementary and strengthen the organisation's financial health.

To build the following summary cards, several techniques were used. The selection of appropriate tools draws on already published material. Also, some experts from different areas (European Venture Philanthropy Association,

Financité) were consulted for the selection process. In parallel, a table was assembled to classify the different types of organisations and their investment profile. We identified the non-profit organisations and the social enterprises as being part of the social economy initiative and therefore concerned by the report.

From there, the funding needs and opportunities emerged and the instruments were chosen. The following summary cards can help the social enterprise choose among the different tools available.

- Charity bonds
- Convertible loans
- Co-operator shares
- Crowdfunding
- Equity
- Quasi-equity
- Social impact bonds
- Social success notes

The summary cards are structured in such a way that the reader first gets an overview of its global characteristics (time frame, risk, life cycle of the organisation, etc.). This ID card will give at first glance an idea of the type of instrument. Each instrument is then detailed in several sections, by including its advantages and risks. Finally, a study case closes each summary card.

Non Profit		Social Enterprises			Socially Responsible Businesses	Traditional for Profit	
Traditional	With income generating activities	Potentially sustainable	Breakeven	Profitable	Profit distributing, socially driven	Practicing CSR	Mainstream market company
Cannot generate financial returns for investors		Require a below market financial return for investors	May generate a below market financial return for investors	Generate competitive financial returns for investors	Societal practices may enhance financial value	Societal practices in order to protect financial value	Limited or no regard for societal practices

Charity Bonds

Context

- ○ Social performance requirement
- ○ Intermediary required
- ☑ Interests/Dividends
- ☑ Risky investment
- ○ Need for capital share
- ○ In the presence of strong capital

Time frame:
- ○ Short term
- ○ Middle term
- ☑ Long term

Cycle of life:
- ☑ Start/Introduction
- ☑ Growth
- ○ Maturity/Rescue plan

Definition

Charity Bonds are issued by charities and social enterprises as a form of long term debt to expand their business operations.

How does it work?

The charity or social enterprise issuing the bond is borrowing money from investors. The organisation is committed to repay the investors in the future in addition to periodic interest payments. Unless specified, it is not possible to request the early repayment of the bond before its final repayment date.

Is this the best funding option?

Generation of financial surplus – To provide interests, the social enterprises need to be sustainable and generate financial surplus.

Advantages and disadvantages

+ Charity bonds offer more favourable terms in comparable to bank loan, with bond issues often unsecured, more flexible terms and of longer duration than comparable bank loan.
+ Charity bonds can potentially allow issuers to secure future income streams, whether they are traded or contractual revenues, grants or donations.
- As a charity bond issuer, a charity or social enterprise enters into a legal obligation with its investors to pay interests.
- Bond investors are likely to demand a high level of transparency and regular financial and social reporting to track the performance over the life of the bond issue.

(Goodenough, 2014)

Policy initiatives

There is no special legal framework for Charity Bonds. Being a kind of bond, it must then refer to the traditional legal framework.

Case study: Scope

In October 2011, Scope announced a £20 million bond programme to generate complementary funding for its charitable activities alongside current donations and philanthropic loans.
The programme allows Scope to expand its income-generating activities such as its network of charity shops, which generate long-term sustainable sources of income for its work with disabled people.
Scope works in partnership with Investing for Good, a specialist social finance intermediary.

The Bond operates in the same way as similar corporate bond products, allowing high net worth individuals, foundations and institutional investors (e.g. wealth and pension fund managers) to invest their capital in a charity for both social and financial return.

It is a flexible programme that allows Scope to raise as much finance as they need for as long as they need – and it is unrestricted, so they can choose how they use it. They have the flexibility to issue sterling bond tranches at varying nominal amounts; for example, the first tranche of debt raises from the market is £2m, which is well within their resources to repay.

Scope reports income of more than £100m a year with £23m of that coming from its charity shops, £15m from donations and the rest from providing services to the public sector. About 3,000 people are employed by Scope which made a surplus of £4m in 2010.
The bond is firmly placed as a commercial activity and Scope is offering a fairly standard return based on their enterprise activity, rather than the social outcomes of their programmes, giving investors certainty over their financial return.

"The major cash investment that we hope to generate through the Scope Bond Programme has the potential to transform the support we can provide to disabled people," said Richard Hawkes, chief executive of Scope.

"It gives us the opportunity to talk to a new and emerging network of prospective supporters and offer them an additional way of investing in Scope alongside traditional donations and philanthropic loans. This is a landmark development for Scope and could revolutionise the way we and other large charities raise finance for our work in the future."
The Scope Bond Programme is listed on the Luxembourg-based Euro MTF stock exchange and follows Scope's Grangewood Venture Philanthropy Project, where outside investors were brought in to finance the construction of homes for people with multiple disabilities.

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Social Impact Bonds

Context

- ☑ Social performance requirement
- ☑ Intermediary required[2]
- ○ Interests/Dividends
- ☑ Risky investment
- ○ Need for capital share
- ○ In the presence of strong capital

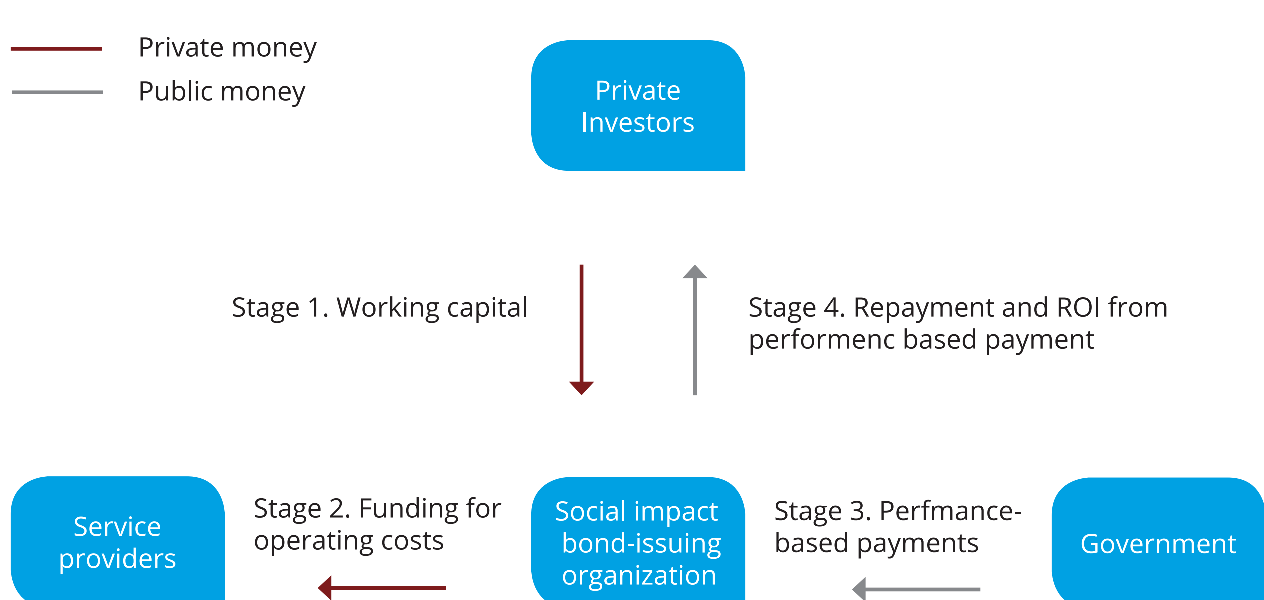
Time frame:
- ○ Short term
- ☑ Middle term[3]
- ☑ Long term

Cycle of life:
- ○ Start/Introduction
- ☑ Growth
- ○ Maturity/Rescue plan

Definition

"A Social Impact Bond is a financial vehicle that brings in non-government investment to pay for services which, if successful, deliver both social value and public sector cost savings. Investors receive a financial return from a proportion of the cost savings delivered." (Bolton & Savell, 2010).

How does it work?



At least four actors are involved in a Social Impact Bond. A "social impact bonds-issuing organisation" will identify potential programmes among social enterprises and elaborate a contract with a government interested in raising a bond. When the contract is secured, this intermediary organisation will issue the Social Impact Bond and raise capital from private investors (Stage 1).

2 Not mandatory, but will facilitate the access

3 Depending on the project

When enough funds are collected, the intermediary will transfer it to service providers. Those will then use the funds to implement the prevention programme chosen in the contract (Stage 2).

After the agreed time period, an independent evaluator will determine whether the target outcome has been reached, according to the contract. If it is the case, the government pays the intermediary a percentage of its saving (Stage 3) and he repays the investors, including a return on investment (ROI) (Stage 4). If the outcome did not meet the expectations, the government owes nothing. In that case, the investors lose their investment (Cox, 2011-2012; Social Finance Inc., 2012).

Social Impact Bonds have been adapted for development countries as well. In the case of Development Impact Bonds, local governments often do not have enough resources to pay investors back. Therefore, donor agencies stand as guarantors of repayment to the investors.

Is this the best funding option?

If certain factors are met, Social Impact Bonds can be an appropriate funding option for a social enterprise.

Preventive intervention – The SIB must be launched for a preventive intervention for which sufficient funding from government is unavailable. The preventive programmes can tackle the social problems at their roots rather than treating their symptoms.

Greater savings than costs – The savings made by the programme must be greater than the intervention and transaction costs. If this condition is not fulfilled, then the SIB programme is not profitable for the government and the investors.

Improved wellbeing – The SIB programme must improve the welfare of the concerned population. It should prevent or improve a bad outcome.

Evidence of efficiency – The intervention produced by the service provider must already have proved its effectiveness and its impact.

Measurability – The impact of the programme must be measurable.

Alignment of incentives – A SIB project must align the incentives of all the stakeholders.

Government commitment – The government must support the use of the SIB as they are committed to repay the investors.

In view of these conditions, some types of programmes are well suited for Social Impact Bonds. For example, intervention focused on behaviour like recidivism, homelessness, health service, workforce development or unemployment. (Mulgan et al., 2011)

Advantages and disadvantages

- + Social Enterprises do not have to reimburse the investors in case of success, as a government is committed to the repayment.
- + Social Enterprises can scale up a service that already works.
- - The social outcome must be measurable and clearly related to the service.
- - Social entrepreneurs might be tempted to select the clients they will help in order to have better results. However, this cherry picking ignores the most-in-need.
- - Little legislation is linked to Social Impact Bonds. They have characteristics of different investment tools, each of them having different regulations.

Policy initiatives

As the tool is not yet well developed in many countries, there is in general little legislation. The assessment has to be done on a case-to-case basis, usually by the intermediary organisation. On its side, the European Commission also tries to improve the exchanges of Social Impact Bond experiences among the member states.

Case study: Social impact bond (SIB) in Augsburg, Germany

In September 2013, the Benckiser Foundation Future launched the first German Social Impact Bond (SIB). Services have started to be delivered under an innovative service model that brings together a range of organisations and interventions with a track record. The services work with young people who have disengaged from education and employment, to help them enter training or employment.

The targeted outcome is the placement of at least 20 members of the target group into a job or an apprenticeship for more than 9 months during the timeline of the project. To achieve this goal the service delivery organisations work with approximately 100 young people.

- the target group is defined as unemployed people below 25 years old in the Augsburg district with:
- no ongoing or successfully completed apprenticeship;
- no current school attendance;
- no current occupation; and
- no contact with an employment agency over the last two years or no participation in agency programmes over the last two years.

The services are being delivered from the shared workspace project Eleven Augsburg, through the collaboration of four service delivery organisations: Apeiros, Education Management Augsburg, Child and Youth Services Hochzoll, and Joblinge.

The Bavarian State Ministry of Labour and Social Affairs, Family and Integration (StMAS) will pay for the outcome once it has been achieved. The Ministry holds a contract with special purpose vehicle called Juvat. Juvat, derived from the Latin *juvare*, translates the central hypothesis of the programme: ‘It works’. This is a pilot project for the Ministry, which they are referring to as “JuMP – youth with perspective”.

There are four foundations investing in the SIB: BHF-BANK Foundation, BonVenture (a social venture capital fund), BMW Foundation Herbert Quandt, and Eberhard von Kuenheim Foundation – the Foundation of BMW AG. The total amount invested is not public.

The law firm Dr. Mohren & Partner will independently evaluate whether targets have been reached and payments should be made.
Additionally, the Faculty of Economic and Social Sciences at the University of Hamburg will perform a process evaluation.

From Emma Tomkinson's blog:
www.emmatomkinson.com/2014/08/20/social-impact-bond-sib-in-augsburg-germany/

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Convertible Loan

Context

- ○ Social performance requirement
- ○ Intermediary required
- ✓ Interests/Dividends
- ✓ Risky investment
- ✓ Need for capital share
- ○ In the presence of strong capital

Time frame:
- ○ Short term
- ✓ Middle term
- ✓ Long term

Cycle of life:
- ✓ Start/Introduction
- ✓ Growth
- ○ Maturity/Rescue plan

Definition

A convertible loan is a loan that allows the investor to convert it into equity at a specified conversion rate and within a specified timeframe.

How does it work?

The borrowed money has to be repaid with interests. However, the debt holder has the option to convert all or a portion of the loan for some equity position in the organisation. The rate of conversion and the period of time are specified before the agreement. (GIZ, 2014)

Is this the best funding option?

To issue a convertible loan, the organisation must fulfil the requirement of both debt and equity features:
Generation of financial surplus – To provide the interests, and then dividends, the social enterprises need to be sustainable and generate financial surplus.

Sharing the same values – As the investors may get some control and voting rights if they convert their loan, the social entrepreneur needs to be sure that they all share the same objective.
Appropriate legal structure – Not all legal structures allow to raise share capital. If the investor decides to convert his loan, the organisation must be able to offer shares.
(National Advisory Board Germany, 2014)

Advantages and disadvantages

+ Providing a convertible loan may take place in exchange for securing more favorable terms on the loan (no prepayment penalties, lower interest rate, payment vacations, etc.).
- The ownership of the organisation will be diluted as the investors convert the loan into shares. Their control and voting rights might affect the corporate culture of the social enterprise.

(GIZ, 2014)

Policy initiatives

Convertible loans are not offered widely amongst European venture lenders. A Convertible Loan Agreement binds the terms and conditions of the conversion of the tool.
(Agreements, 2012; GIZ, 2014)

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Co-operator Shares

Context

- ☑ Social performance requirement
- ☐ Intermediary required
- ☑ Interests/Dividends
- ☑ Risky investment[4]
- ☑ Need for capital share
- ☑ In the presence of strong capital

Time frame:
- ☑ Short term
- ☑ Middle term
- ☐ Long term

Cycle of life:
- ☑ Start/Introduction
- ☑ Growth
- ☑ Maturity/Rescue plan

Definition

Co-operator shares are a specific form of equity investment that is well adapted for social enterprises operating under the legal form of cooperatives.

As mentioned previously, a co-operative is “an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise.” (International Co-operative Alliance, 2015)

The seven principles that guide all co-operative organisations have been defined by the International Co-operative Alliance as the following:

- Voluntary and open membership
- Democratic member control
- Member economic participation
- Autonomy and independence
- Education, Training and Information
- Co-operation among Co-operatives
- Concern for community

Co-operatives can be small structures with few members, but can also be much larger, like citizens’ co-operatives for energy, for agriculture or for short food channels, where the members are not always direct beneficiaries.

4 According to the number of members

How does it work?

Members who are beneficiaries (workers, savers, consumers, producers, according to the type of co-operative) and investors at the same time contribute to the capital of their co-operative by buying shares. They are rewarded primarily through a social return rather than a monetary dividend. However, they still receive limited financial compensation on their investment.

The surplus can be allocated for the development of the co-operative, to support other activities approved by the members or be redistributed (for a part), as a discount for the members. When a member wants to exit the co-operative, he can cash his shares according to the terms and conditions that protect the co-operative's financial security.

Is this the best funding option?

A co-operators' share is only viable under certain circumstances.

Generation of financial surplus – To provide the dividends, the co-operative needs to be sustainable and generate financial surplus.

Sharing the same values – As the investors get some control and voting rights in exchange for their investments, the social entrepreneur needs to be sure that they all share the same objective.

Member support – The co-operative needs to attract members that allow its development.

Advantages and disadvantages

+ Co-operative shares can be used in all stages of the organisation's life cycle.
- The ownership of the organisation is diluted as the members get shares, control and voting rights.
- Co-operative shares do not replace the revenue streams.

Policy initiatives

In several European countries there is a cooperative law. While in some countries there is a general cooperative law that is applied to all business sectors, in others, each economic sector can rely on a dedicated cooperative legislation. Despite their differences, which are mainly due to diverse cultural, economic and historical backgrounds, national cooperative laws share the cooperative values and principles, which is what differentiates cooperative enterprises.

The EU promotes cooperatives wishing to engage in cross-border business, by making legislative provisions that take into account their specific features. It allows the creation of new cooperative enterprises by natural or legal persons at the European level. It ensures the rights of information, consultation and participation of employees in a European Cooperative Society (SCE). (EUR-Lex, 2015)

Case study: Damnet

The founders of Damnet chose the cooperative status because they were convinced that this status could create a business that is “a great place to work”. The work environment and the employees involvement positively reflect on the quality of service to customers.

The partners now consider that they collectively belong to the company and their provision of labour only makes sense from the perspective of a common project. The company aims at the fulfilment at work at developing the potential of each individual and of the community (taking responsibility, changing functions, lifelong learning, flexible working conditions, ...), and the establishment of a different customer relationship.

The cooperative was inspired by the French principles of cooperatives. After one year of service, every employee can become a partner by taking at least one share of the capital. The principle of decision states that ‘one person is synonymous with one vote’, while the traditional principle states that ‘one share is equal to one vote’.

Damnet is a cooperative company approved by the Ministry of Economy. Cooperatives are, by nature, the promoter of socially responsible entrepreneurship. This approval ensures that Damnet works in compliance with the cooperative values and principles.

Damnet participates as of 2015 to the “Coop” brand to strengthen the identity of cooperatives, led by the International Co-operative Alliance.

From Damnet’s website: www.damnet.be/damnet/la-cooperative.html

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Equity Investment

Context

- ○ Social performance requirement
- ○ Intermediary required
- ☑ Interests/Dividends
- ☑ Risky investment
- ☑ Need for capital share
- ○ In the presence of strong capital

Time frame:
- ○ Short term
- ○ Middle term
- ☑ Long term

Cycle of life:
- ☑ Start/Introduction
- ☑ Growth
- ○ Maturity/Rescue plan

Definition

Equity capital is provided by external investors in return for ownership rights (shares) in the organisation. The shareholders are compensated for the risk taken by getting rewards, under the form of dividends (part of the annual profit).

How does it work?

In exchange for his investment in the social enterprises, the investor gets a share of the company. He will not receive a regular annual payment but a share of the profits generated by the social enterprise. Besides, the investor also has certain control and voting rights, which depend upon the legal form of the enterprises and which are usually structured in a contract. When the social investor wants to sell his shares, it may take a long time to find another investor to exchange them as there is no established market for the shares.

Is it the best funding option?

Equity financing is only viable under certain circumstances.

Generation of financial surplus – To provide the dividends, the social enterprises need to be sustainable and generate financial surplus.

Sharing the same values – As the investors get some control and voting rights in exchange for their investments, the social entrepreneur needs to be sure that they all share the same objective.

Appropriate legal structure – Not all legal structures allow to raise share capital. In the social economy field, the cooperative form is the most appropriate structure to grant participation rights. However, there is a maximum return rate and some restrictions about non-shareable reserves. (National Advisory Board Germany, 2014; KnowHowNonProfit, 2014a)

Advantages and disadvantages

+ As the dividends depend on the annual profit of the social enterprise, the payments are variable and do not penalize the organisation in case of poorer results.
- The ownership of the organisation is diluted as investors get shares, control and voting rights. These might affect the corporate culture of the social enterprise.
- Equity investment does not replace the revenue streams.

(Schwab Foundation, 2011; Henley, 2013)

Policy initiatives

The regulation of equity capital is robust for traditional organisations. Concerning social enterprises, not all of them can legally use this funding tool because their legal structures usually do not allow issuing shares or distributing profits. Only an appropriate legal structure can raise share capital: companies limited by shares, a community interest company (limited by shares), co-operatives or some types of social enterprises. Furthermore, the amount of dividends is usually limited to a maximum percentage of the profit by the legal forms. On the other hand, charities and companies limited by guarantee cannot raise equity finance. (KnowHowNonProfit, 2014; Big Society Capital)

Case study: Traidcraft

Traidcraft was founded in 1974 to promote the use of fair trade to relieve poverty in developing countries. CAF Venturesome was approached in 2002 as the company was launching a £3.25m share offer to finance capital expenditure and working capital, in response to growing interest in and demand for fair trade products.

CAF Venturesome was attracted by Traidcraft's social mission and its innovative use of share capital. CAF Venturesome was able to invest £25,000 to support the company and signal its support to other charities and foundations to encourage them to follow suit. This was a new market in 2002, which has steadily grown over the years.

Currently, Traidcraft has two components: the public limited company, Traidcraft plc, which sells fair trade products in the UK; and a development charity, Traidcraft Exchange, which works with poor producers in Africa and Asia.

The latter has almost five million shares in issue, most of which are held by some 5,500 individuals. CAF Venturesome was able to exit this investment in 2010 by selling its shares. However, exiting equity investments can be difficult in the sector as most organisations are not listed on a stock exchange so a broker will be required to match a specific buyer with specific seller of shares.

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Quasi-Equity Investment

Context

- ○ Social performance requirement
- ☑ Intermediary required
- ☑ Interests/Dividends
- ☑ Risky investment
- ○ Need for capital share
- ○ In the presence of strong capital

Time frame:
- ○ Short term
- ○ Middle term
- ☑ Long term

Cycle of life:
- ☑ Start/Introduction
- ☑ Growth
- ○ Maturity/Rescue plan

Definition

Quasi-equity is a financial instrument which is usually structured as a debt where the financial return is calculated as a percentage of the future organisation's revenue. (Bugg-Levine, Kogut, & Kulatilaka, 2012; GIZ, 2014)

How does it work?

A quasi-equity investment is a high risk loan. However, unlike a loan, the repayment depends on the financial success of the organisation. If the financial performance is not achieved, a low (or zero) return is paid to the investor. If the financial performance is better than expected, the investor will get a higher financial return. The returns can be limited in duration or capped. (Balbo, Hehenberger, Mortell, & Oostlander, 2010; GIZ, 2014)

Is this the best funding option?

Income generating organisation – To be able to repay the investors, the organisation must have income generating activities.

Intermediary between debt and equity – When debt financing is inappropriate or too onerous for the organisation, or where share capital may not be possible due to the legal structure, quasi-equity may be the solution.

In case of low equity capital – Quasi-equity may also be used when the equity capital is low.
(Balbo, et al., 2010; KnowHowNonProfit, 2014)

Advantages and disadvantages

+ Quasi-equity investment is beneficial when equity capital and shares are not possible due to the organisation's legal structure.
+ The investor does not have a direct claim on the governance and ownership of the enterprise. It thus cannot affect the culture of the organisation.
+ The risk is shared between the investors and the organisation.
- Quasi-equity may become a very complex instrument (defining thresholds, the different types of income, etc.).

Policy initiatives

Quasi-equity may be offered under the legal form of a Revenue Participation Agreement, which is an agreement developed by Venturesome in the United Kingdom. The intermediaries who provide quasi-equity may structure it in the form of legal agreements.

Case study: Charity Technology Trust

Charity Technology Trust (CTT) works with charities to help them become more efficient through the use of information technology. In 2006, the charity began developing a technology donation portal, CTX, supplying brand name software at very low cost to charities. It required up to £100,000 of investment in infrastructure and marketing to enable it to launch and market this portal. Initially, CAF Venturesome provided a bridging loan of £50,000 to provide confidence to the management team as they fundraised for development capital, and a standby facility of £50,000 to underpin cashflow as the charity's core operations grew.

CTT had difficulties in accessing grant funding, however, as it transitioned to a more commercial model. So, in 2007, CAF Venturesome offered the charity a further £50,000 in the form of quasi-equity, with repayment to come from a 2 percent share of future gross revenues. The facility was offered over seven years, with repayment capped at double the initial investment.
This was a high risk for CAF Venturesome as there was no certainty that the new, scaled-up business model would work, although CTT's forecasts were based on reasonable and well-researched assumptions. CTT's revenue exceeded forecast, and the charity decided to repay the entire investment to CAF Venturesome, four years ahead of schedule – giving CAF Venturesome a handsome return on its investment. From KnowHowNonProfit:
www.knowhownonprofit.org/funding/social-investment-1/investment-types/quasi-equity-revenue-participation

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Crowdfunding

“Crowdfunding involves an open call, mostly through the Internet, for the provision of financial resources either in form of donation or in exchange for the future product or some form of reward to support initiatives for specific purposes.” (Belleflamme, P., Lambert, T., & Schwienbacher, A., 2014)

Different models of crowdfunding exist. Currently, at least 4 models can be identified. Each of them has its particularities, even though the basic concept stays the same: people around the world can fund a project on an online crowdfunding platform. The four models are:

- Donation crowdfunding
- Reward-based crowdfunding
- Lending or debt crowdfunding
- Equity-based crowdfunding

Donation & Reward-Based Crowdfunding

Context

- ○ Social performance requirement
- ☑ Intermediary required
- ○ Interests/Dividends
- ○ Risky investment
- ○ Need for capital share
- ○ In the presence of strong capital

Time frame:
- ☑ Short term
- ○ Middle term
- ○ Long term

Cycle of life:
- ☑ Start/Introduction
- ☑ Growth
- ○ Maturity/Rescue plan

Definition

Donation crowdfunding takes place when investors get nothing in exchange for their donations. For its part, reward-based crowdfunding is when current or future of goods or services are offered in exchange of the contribution. In both cases, there is no financial reward. (Crowdfund Insider, 2015)

How does it work?

For donation crowdfunding, people give money to support the project but do not get anything in exchange. For reward crowdfunding, the organisation gives different types of symbolic gifts according to the amount of the contribution.

There are no banking institutions involved in a crowdfunding fundraising. The only intermediary between the crowd and the entrepreneur is the online platform, which usually takes a commission of 4-5% of the total amount of successful projects as remuneration.

Is it the best funding option?

To use crowdfunding, the organisation must have certain characteristics to appeal the crowd:

Clear and realistic project – The project needs to be simply explained and must be understandable for everybody. It needs to be realistic and transparent about the goal and the costs.

Short term oriented – The crowdfunding campaign is limited in time. It implies that the crowd will be willing to know rapidly the outcome of the project.

Popular – As the funds will come from the population, the idea must be popular and inspire people.

Advantages and disadvantages

+ Crowdfunding reduces the cost of the capital as there are no banking institutions. The fundraising is thus less expensive and faster than traditional funding sources as anybody on the internet can contribute to the project. However, the platform usually takes around 5% of the collected amount as remuneration.
+ Crowdfunding campaigns allow the entrepreneur to know what people think of his project. He can collect free advice and comments from the crowd to improve the product or project. Therefore, it can, to a larger extend, confirm the legitimacy of the project with other funding alternatives.
- The legislation of many countries is not adapted yet to crowdfunding possibilities.
- Donation and reward crowdfunding is short term oriented and has the same shortages as traditional donations (usually unstable, according to the projects, the period of the year or the global environment).

Policy initiatives

The legislation of crowdfunding is not yet developed in many countries. Usually, donation and reward crowdfunding are outside the definition of financial services and therefore are not subject to financial regulations. To know more about specific country regulation, a report called "Review of Crowdfunding Regulation 2014" is available on the European Crowdfunding Network website
www.eurocrowd.org/2014/12/12/ecn-review-crowdfunding-regulation-2014/.

Case study: How the CPWR Fights Terrorism with Crowdfunding

Combatting violence in the world, especially terrorist violence, requires a multi-faceted approach, and the Council for a Parliament of the World's Religions (CPWR) promotes one of the most important avenues toward that goal: increased interfaith understanding.

The CPWR is the world's largest and oldest global interfaith organisation, and offers a number of programmes and campaigns that seek to promote greater harmony and justice around the world. Aside from the many challenges of their main mission, the CPWR was also recently in danger of shutting down completely due to insufficient funding. But with a well-run campaign and the help of CauseVox, the CPWR is back to full strength after having raised over $150,000 ($64,000 of it online).

How did they do it? They brought a diverse group of people together and inspired them to support a common cause. Using a CauseVox campaign page and a simple video, they invited people to "Become hope builders." Then, with an all-out online blitz empowered by their support network and constituent communities, they reached their goal just in time to save their organisation.

From The CauseVox Blog: www.causevox.com/blog/world-religions-fight-terrorism-through-crowdfunding/

Lending Crowdfunding

Context

- ○ Social performance requirement
- ☑ Intermediary required
- ☑ Interests/Dividends
- ☑ Risky investment
- ○ Need for capital share
- ○ In the presence of strong capital

Time frame:
- ○ Short term
- ☑ Middle term
- ☑ Long term

Cycle of life:
- ☑ Start/Introduction
- ☑ Growth
- ○ Maturity/Rescue plan

Definition

Lending crowdfunding is when an investor lends money to the organisation with the understanding that the loan will be repaid with interest. (Crowdfund Insider, 2015)

How does it work?

For lending or debt crowdfunding, as for traditional loans, investors get their initial contribution plus financial returns for their participation in the project. Again, there are no banking institutions involved in a crowdfunding fundraising. The only intermediary between the crowd and the entrepreneur is the online platform, which usually takes a commission of 4-5% of the total amount of successful projects as remuneration.

Is it the best funding option?

To use lending crowdfunding, the organisation must have certain characteristics:

Clear and realistic project – The project needs to be simply explained and must be understandable for everybody. It needs to be realistic and transparent about its goal and costs.

Short term oriented – The crowdfunding campaign is limited in time. It implies that the crowd will be willing to know rapidly the outcome of the project.

Popular – As the funds will come from the population, the idea must be popular and inspire people.

Generation of financial surplus – To provide the interests and repay the investor, the social enterprise needs to be sustainable and generate financial surplus.

Advantages and disadvantages

+ Crowdfunding reduces the cost of the capital as there are no banking institutions. The fundraising is thus less expensive and faster than traditional funding sources as anybody on internet can contribute to the project. However, the platform usually takes around 5% of the collected amount as remuneration.
+ Crowdfunding campaigns allow entrepreneurs to know what the people think of his project. He can collect free advice and comments from the crowd to improve the product or project. Therefore, it can, to a larger extend, confirm the legitimacy of the project with other funding alternatives.
- The legislation of many countries is not adapted yet to crowdfunding possibilities.
- The organisation enters into a legal obligation with its investors to pay interests.

Case study: Kiva

The Kiva platform was created in 2005 in the United States and is one of the first crowdfunding platforms. The platform, organised as a non-profit one, allows people from developed countries to lend money to small entrepreneurs in developing countries. It is therefore a model of lending crowdfunding. The special feature here is that the contributors do not receive any interest on their loan (0% interest).

In practical terms, a contributor chooses an entrepreneur among hundreds of others, based on their stories and projects. The contributor can then lend $25 to $150 to support the project. The repayment term varies from project to project and can be done gradually or at once.

Kiva does not take commission on the final amount. Kiva works with additional donations from contributors and partnerships with companies or foundations. In 2015, $718,885,775 was lent through the platform and the contractor's repayment rate reached 98.71%.
From Kiva's website: www.kiva.org/

Equity Crowdfunding

Context

- ○ Social performance requirement
- ☑ Intermediary required
- ☑ Interests/Dividends
- ☑ Risky investment
- ☑ Need for capital share
- ○ In the presence of strong capital

Time frame:
- ○ Short term
- ☑ Middle term
- ☑ Long term

Cycle of life:
- ☑ Start/Introduction
- ☑ Growth
- ○ Maturity/Rescue plan

Definition

Equity crowdfunding is crowdfunding where, in exchange of contributions, the investors get company shares. The idea is very similar to how common stock is bought and sold on the stock market.
(Crowdfund Insider, 2015)

How does it work?

People invest money in exchange for a share in the organisation. As traditional equity, the value of the share increases if the project is successful. If not, the investor could lose his investment.
There are no banking institutions involved in a crowdfunding fundraising. The only intermediary between the crowd and the entrepreneur is the online platform, which usually takes a commission of 4-5% of the total amount of successful projects as remuneration.

Is it the best funding option?

In order to use equity crowdfunding, an organisation must have a given number of appealing characteristics for the mass:

Clear and realistic project – The project needs to be simply explained and must be understandable for everybody. It needs to be realistic and transparent about the goal and the costs.

Short term oriented – The crowdfunding campaign is limited in time. It implies that the crowd will be willing to know rapidly the outcome of the project.

Popular – As the funds will come from the population, the idea must be popular and inspire people.
Generation of financial surplus – To provide dividends, the social enterprises need to be sustainable and generate financial surplus.

Sharing the same values – As the investors get some control and voting rights in exchange of their investments, the social entrepreneur needs to be sure that they all share the same objective.
Appropriate legal structure – Not all the legal structures allow to raise share capital.
(KnowHowNonProfit, 2014)

Advantages and disadvantages

+ Crowdfunding reduces the cost of the capital as there are no banking institutions. The fundraising is thus less expensive and faster than traditional funding sources as anybody on internet can contribute to the project. However, the platform usually takes around 5% of the collected amount as remuneration.
+ Crowdfunding campaign allows the entrepreneur to know what the people think of his project. He can collect free advice and comments from the crowd to improve the product or project. Therefore, it can, to a larger extent, confirm the legitimacy of the project with other funding alternatives.
+ As the dividends depend on the annual profit of the social enterprise, the payments are variables and do not penalize the organisation in case of poorer results.
- The legislation of many countries is not yet adapted to crowdfunding possibilities.
- The ownership of the organisation is diluted as the investors get shares, control and voting rights. These might affect the corporate culture of the social enterprise.

(Henley, 2013)

Case study: CrowdMission

Entrepreneur Karen Darby has launched a crowdfunding site to fund social, environmental and health-related businesses. CrowdMission challenges traditional banks and venture capitalists and put investment opportunities in the hands of ordinary people.

"*CrowdMission is all about making money and making a difference. We connect investors to ambitious, high-growth businesses with a social dimension. These businesses could one day be real game-changers and have a truly beneficial effect on the planet*", said Darby.

CrowdMission allows ordinary people to invest from as little as £10 in return for shares in businesses that benefit society. It has set itself a target to help, nurture and support 10,000 social entrepreneurs in the next five years.

Every business that seeks funding through the CrowdMission platform must provide an obvious benefit to society, health or the environment. This social impact must be above-and-beyond the commonplace social benefits of running a business, such as the creation of jobs or stimulation of the local economy. CrowdMission is particularly keen to work with social entrepreneurs, green energy businesses and bioscience companies (…) From Crowdfund Insider:
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Social Success Notes

Context

- ○ Social performance requirement
- ✓ Intermediary required
- ✓ Interests/Dividends[5]
- ✓ Risky investment
- ✓ Need for capital share
- ○ In the presence of strong capital

Time frame:
- ○ Short term
- ✓ Middle term
- ✓ Long term

Cycle of life:
- ✓ Start/Introduction
- ✓ Growth
- ○ Maturity/Rescue plan

Definition

A Social Success Note is a pay-for-performance arrangement where a private investor will give a loan or provide equity to a social enterprise. The organisation is responsible for paying back the investment only. If the predetermined social target is reached, a philanthropic donor will give the private investor an "impact payment", which is a transfer of the value of the social outcome in the form of an additional return for the private investor.
(Yunus & Rodin, 2015; Yunus Social Business, 2015)

How does it work?

"A foundation interested in rural energy access could seek out a social business that has developed a sustainable model for a decentralized solar off-grid or mini-grid that can power homes and businesses at an affordable price. Together, the foundation and the solar business would determine what success looks like, in terms of the number of households or businesses that should feasibly get access to this energy. They would then go in search of commercial investors to provide a low-interest loan for the project. If the social business ends up reaching its customer target, it repays the loan and the foundation adds its impact payment for the investors. If the social business doesn't reach its target, it is still on the hook for repaying the loan." (Yunus & Rodin, 2015)

Is this the best funding option?

Social success notes are the best funding option when the enterprise meets the following characteristics:

- Size of the business – when the business is either too small for domestic commercial banks or too big for micro-finance institutions
- Income generating organisation – to be able to repay the loan, the organisation must have income generating activities.

(Yunus Social Business, 2015)

5 The interest, here called "impact payment", is not supported by the social enterprise but by a philanthropic donor.

Advantages and disadvantages

+ Allows capital flows into underfunded sectors deemed traditionally too risky or unprofitable for mainstream capital.
+ Allows the social enterprise to go deeper into its area of social impact, like targeting a poorer customer segment than traditional investment hurdle rates would allow.

(Yunus Social Business, 2015)

Case study:

Yunus Social Business and The Rockefeller Foundation are working together to launch the pilot in 2016 with one of Yunus Social Business' investment-ready social businesses. (Yunus Social Business, 2015)

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Conclusion

This list of funding tools is not exhaustive but provides an overview of the large scope of instruments available. Many alternatives are possible to finance social impact activities. Whilst private investments guarantee a sustainable support to the organisation, foster innovation and allow to scale up the activities, there are still some points to keep in mind.

First of all, all the funding tools are more or less risky. Equity capital is the riskiest one, followed by quasi-equity and bonds in general. Risk can never be completely eliminated but it can be reduced, when well managed. Being sustainable is not only about money but also about having good governance (risk management, financial planning, etc.). Risk can be managed through several principles:

- A good strategic planning will allow the organisation to take on investment finance responsibly.
- The board of the organisation is responsible for any default. Being engaged into decisions about external finance is therefore vital.
- A good communication and transparency between the organisation and the potential investors will ensure that difficulties and concerned are resolved at an early stage.
- Experts and consultants can help the organisation if advice is needed concerning investment or strategic planning.
- Finally, diversifying the funding sources will reduce the risks for the organisation. Relying on just one source of finance might be hazardous in case of failure.

Second, to remain sustainable, the organisation must evolve in its funding process. Many tools are available and some are more relevant for some activities, at certain lifetime stages of the organisation, combined with other funding tools as well. Their use must be dynamic and not frozen in time. Proactivity brings better management of the balance sheet and therefore increases the social impact of the organisation, which is the ultimate goal. Also, not all organisations are best suited for private investments. A deep analysis must be completed to determine if and which instrument is the best option for the organisations' needs.

Finally, as mentioned before, private investment tools must not be seen as a substitute to the current traditional funding mechanisms but as an added value for the organisation. They need to be used in a complementary manner, to foster innovation and to ensure the financial sustainability of the social enterprises. Donations, subsidies and loans must not be excluded under the pretext of the use of private funding tools. To reduce risk as much as possible and ensure the sustainability of the organisation, financing should be adequately diversified.

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