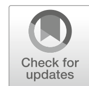
Building a Thriving Ecosystem for Social Enterprise Finance



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The Social Finance Market: State of Play

Social finance is on the rise. Lately, the ecosystem experiences a slow but steady evolution. In Germany, *impact investing* has "strongly benefited from more attention as well as national and international initiatives" as a study confirms (Bertelsmann Foundation 2016).[1] Yet the market infrastructure is far from being perfect. In an ideal world, all types of capital suppliers would join forces to support social organizations while they attack the most pressing social and environmental problems. And all target investees, most prominently social enterprises, would be *investment-ready* and well prepared to take on such capital to truly reach scale.

But reality looks a bit gloomier. On the one hand, the estimated assets investible for positive impact have almost tripled to EUR 70 million in Germany between 2013 and 2016. On the other, this trend is largely due to a relatively small number of pioneers, among them two social venture capital funds, several business angels, family offices and foundations as well as specialized intermediaries such as the Financing Agency for Social Entrepreneurship (FASE). There is much to be done if the market is to reach true scale. Worldwide, impact investing accounts for just a fraction of the assets available for investment. The Global Impact Investing Network (GIIN) estimates that while its more than 200 large-scale members manage trillions of USD in total assets, only USD 114 billion went into impact investments so far (GIIN 2018).[2] Thus, impact investing is "a niche market in most developed countries, with

[1] Bertelsmann Stiftung: "Social Impact Investment in Deutschland 2016: Kann das Momentum zum Aufbruch genutzt werden?" https://www.bertelsmann-stiftung.de/de/publikationen/publikation/did/social-impact-investment-in-deutschland-2016/

[2] Global Impact Investing Network (GIIN), https://thegiin.org/impact-investing/need-to-know/#s8

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K. Wendt (ed.), *Positive Impact Investing*, Sustainable Finance,
https://doi.org/10.1007/978-3-319-10118-7_11

limited evidence of its financial performance" (FASE, Ashoka and McKinsey 2016). But it is strongly gaining traction, especially among wealthy millennials.[3]

Social finance is a vital component in making the ecosystem evolve. Like a hub, it connects the three main spokes—private, public and people sectors—by creating innovative forms of investment capital that include social and financial considerations. If the social ecosystem is to thrive and "pick up the pieces left behind through the misdeeds, negligence, or oversight of the state and enterprise ecosystems" (Cheng and Mohamed 2010),[4] it urgently needs to overcome the barriers between capital supply and demand. New finance solutions are very important in this: They serve as a lubricant to make the wheel of innovation run more smoothly. Yet to find out how to exactly achieve this goal means understanding the market actors first.

Today, impact investors target a wide range of investment strategies and risk-return-impact profiles. In essence, these capital suppliers can be divided up in two major groups: *impact-first investors* and *financial-first impact investors*. The vast majority—more than 80% according to the latest GIIN survey[5]—belong to the second group. Its members expect risk-adjusted market-rate or near-market financial returns on top of an attractive, measurable impact. However, this is a profile that most social enterprises cannot fulfill at this stage of the ecosystem. While there are many different kinds of vehicles, sectors, geographies and dimensions for impact investing, *social enterprises* represent a very specific type of investee: They are double bottom line businesses, developing innovative approaches, models or practices for resolving societal challenges in an entrepreneurial way. Their main objective is "to have a social impact rather than make a profit for their owners or shareholders",[6] a defining characteristic that most investors don't find too appealing—at least not yet. In addition, many financiers view direct investments in early-stage social enterprises as complicated, costly (in terms of transaction fees) and high-risk.

Poor access to finance for social enterprises is a well-known problem. Several pan-European studies have outlined the current imperfections in the social finance market.[7] The European Commission's *Social Business Initiative*[8] is trying to address this very challenge with several calls for action to improve the framework. What

[3]Toniic: "Millennials and Impact Investment", 2016.

[4]Willie Cheng, Sharifah Mohamed: "The World that Changes the World: How Philanthropy, Innovation, and Entrepreneurship are Transforming the Social Ecosystem", 2010.

[5]Global Impact Investing Network (GIIN), JPMorgan Chase & Co: "Annual Impact Investor Survey", 2017, https://thegiin.org/knowledge/publication/annualsurvey2017

[6]European Commission, http://ec.europa.eu/growth/sectors/social-economy/enterprises/index_en.htm

[7]For example: Wolfgang Spiess-Knafl, Stephan A. Jansen: "Imperfections in the social investment market and options on how to address them", an ecosystem report on behalf of the European Commission, 2013, https://www.zu.de/info-wAssets/forschung/dokumente/cisoc/Final-Report-Imperfections-in-the-Social-Investment-Market-ZU-vfinal.pdf

[8]European Commission: "The Social Business Initiative", 2014, http://ec.europa.eu/internal_market/publications/docs/sbi-brochure/sbi-brochure-web_en.pdf

makes the situation worse is that even existent market players do not seem to cooperate very well. Different suppliers of financing apply a broad range of mostly incoherent and unrelated eligibility criteria, return expectations, conditions for repayment as well as requirements for accounting and reporting. This often leaves social enterprises lost between various financing planets, struggling to find the right sources that give them leeway to survive and thrive. Lack of growth capital is a serious market failure: If unsolved, it prevents social enterprises from thinking big and creates a vicious circle for society. Not enough capital, not enough social innovation.

Given limited budgets, the public sector alone won't be able to finance the necessary solutions. In Germany, to "fully tackle the lack of affordable housing, the increase in lifestyle diseases, the shortage of care for the elderly, and long-term unemployment reveals a projected shortage of nearly EUR 50 billion by 2025—a sixth of the 2015 federal budget".[9] Recent challenges such as the refugee crisis will add to this immense challenge. Mobilizing private capital for impact investing has therefore become a top priority on the global agenda and a pillar of the *blended finance* movement.[10]

With respect to social enterprises, the challenges vary at different stages of the life cycle. The most serious gap is ajar in the segment of early-stage financing. Social enterprises in Europe typically require EUR 100,000–500,000 to approach the market and prove that their business models and expectations for impact are valid. But in order to do so, they need to invest: teams have to be built up, products and services enhanced and new infrastructure developed. Without external growth capital, this is hard to achieve. Most social enterprises are not able to cover more than 75% of their operating costs with revenues at this stage. At the same time, relatively small deals and high-risk development phases require risk sharing among investors. This is an "asset" that is currently hard to come by: The majority of capital suppliers prefers to wait at the end of the pipeline. There, risk and return seem to be much more appealing, since mature investees have typically reached break-even and therefore represent less risky targets. As a result, early-stage social enterprises often find themselves on the edge of a precipice: a strategic financing gap where the needs for funding tend to be "too big for donations/philanthropist and too small and risky for institutional (social) investors" (FASE 2015). This gap is illustrated in Fig. 1.

For the ecosystem as such, this is a catch 22 situation: If social enterprises fail to survive this *valley of death*,[11] the pipeline for later-stage investors will sooner or later

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[9]FASE, Ashoka, McKinsey: "Achieving impact for impact investing—a roadmap for developed countries", 2016, https://www.mckinsey.de/files/report_impact_investment.pdf

[10]World Economic Forum, OECD: "Blended Finance Vol.1: A primer for development finance and philanthropic funders", 2015, http://www3.weforum.org/docs/WEF_Blended_Finance_A_Primer_Development_Finance_Philanthropic_Funders_report_2015.pdf

[11]Rainer Höll and Felix Oldenburg, Ashoka: "Wie überwinden wir Hürden für soziale Problemlöser?

Sechs Ansätze zur Verbreitung von sozialer Innovation und Social Entrepreneurship in Deutschland", 2010, http://germany.ashoka.org/sites/germanysix.ashoka.org/files/Ashoka_SozialeInnovation.pdf

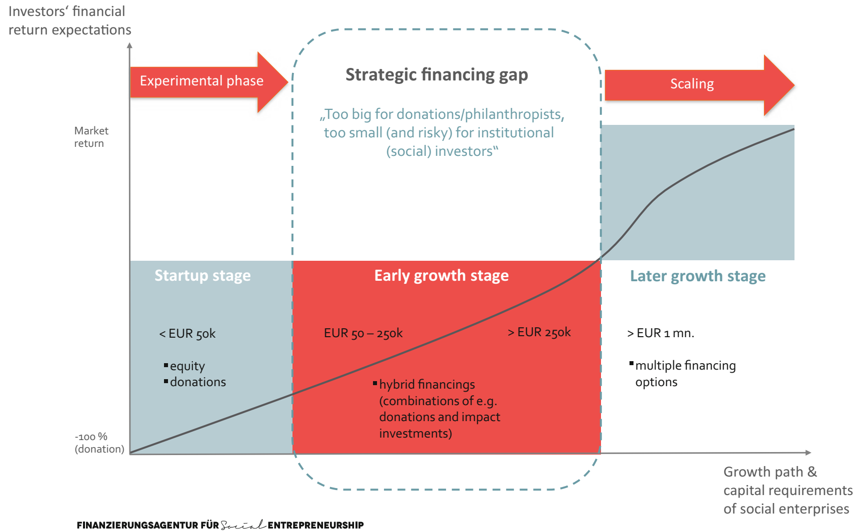

Fig. 1 The strategic financing gap (Source: FASE)

dry out. For society at large, not addressing this missing link will leave social enterprises incapable of fulfilling their roles as agents of innovation. Much is at stake: If the Europe 2020 targets, the Sustainable Development Goals and the Paris climate accord shall be achieved, these double bottom line actors need to be part of the solution. They have to be equipped with the resources they need to tackle the problems at hand.

To summarize, the social finance ecosystem has to overcome the following failures in order to flourish:

1. a limited investor base,
2. too few (or too small) specialized intermediaries,
3. an insufficient availability of investment products,
4. a weakness in social enterprises' investment readiness, and
5. a need for dedicated impact investment and social enterprise advisors.

In the following chapters, we will address a number of important building blocks and examples how to better shape the ecosystem. In addition, we will share a case study that puts our learnings and blueprints for replication into a more practical perspective. This will hopefully assist more impact actors in entering the stage and contribute to an evolution of the social enterprise finance market.

Building an Ecosystem for Social Enterprise Finance

Understanding the Needs

A key to overcoming barriers is to understand the needs of all market participants. Across Europe, these barriers have a varying degree of importance, but there are several shared hurdles:

On the capital supply side, *impact-ready* investors are still a rare breed. Most financiers willing to tap into social enterprise finance miss the appropriate knowledge how to assess—and measure—the dimension of social impact. In addition, they often fail to grasp the unusual double bottom-line business models of their potential investees. Innovative financing models, on the other hand, are a second missing link. These models are capable of blending funders from different financing planets, for example philanthropists and impact investors, and enable more effective solutions. A third market failure prevails with respect to facilitators such as qualified intermediaries and specific market places. These actors are important links that provide practical knowledge and to make both sides meet and match.

On the demand side, most social enterprises still heavily depend on grants. This hinders them in becoming self-sustainable and capable of accessing capital markets. The legal frameworks are another stumbling block. For example, legal forms do not cater well to the specific needs of social enterprises. In order to scale and attract different types of funders, some social enterprises thus adopt hybrid organizational structures: They separate their activities into those that are more business-like and generate income, and those that are high-impact but can't be paid for by their target groups or beneficiaries. As a result, a combination of non-profit and for-profit entities (*structural hybrid*) is quite common in the German social entrepreneurship scene.

In general, the market for social finance is rather intransparent. Demand and supply do not match very well. One of the reasons for this phenomenon is that a vast number of social enterprises are not yet *investment-ready:* They need substantial time, money and effort to get to a point where they become attractive investment candidates. For suppliers of repayable capital, a social enterprise has to have "the capacity and capability to seek and utilize investment".[12] This so-called *investment readiness* involves a number of essential elements, for example:

(a) a compelling *theory of change*[13] that articulates how the enterprise exactly intends to achieve positive impact on society,
(b) a convincing and sustainable business model that illustrates how the target group (s) shall be reached, which products or services provide an effective solution to the problem and how they generate revenues,
(c) sufficient management capabilities, resources and leadership to implement the enterprise's mission,

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[12]Investment and Contract Readiness Fund, http://www.beinvestmentready.org.uk/about/glossary/
[13]For more details visit http://www.theoryofchange.org/

(d) a well-grounded financial plan and financing model that supports this path, and
(e) a proof of concept, showing that the business model and the impact work in practice.

Accelerators, incubators and other specialized supporters are therefore important to make the ecosystem function. They allow social enterprises to receive the right kind of help, making them ready to attract the right kind of capital at the right time.

When looking more closely at the investor side, the annual impact investor survey by GIIN[14] provides sobering insights: 66% of the respondents continue to target risk-adjusted market rate returns. Those investors seek to achieve the same financial outcomes as compared to financial engagements in commercial, privately-held enterprises with identical risk profiles. Positive impact just comes on top of this expectation. Additional 18% of global impact investors target lower returns but still want to see close to market-rate IRRs. Only a fraction of 16% is fine with financial returns that range closer to capital preservation. Yet this is precisely the profile that most social enterprises represent when searching for growth capital—at least in developed countries. While there is enough investment capital around, European markets therefore remain imperfect. "There is a significant mismatch between the available financing volume, investors' expectations and the actual needs of social entrepreneurs" (Oldenburg and Struewer 2016).[15]

Many social enterprises typically operate with business models offering a potential return range of minus 100% and plus 5% per annum. Although these models may generate significant positive external effects—for example creating substantial savings for the state or welfare system—they tend to be too commercial for philanthropists and too social and financially unattractive for impact investors. It may sound absurd, but social enterprises often sit between two stools. Classic philanthropists become suspicious once their targets earn income and "threaten" to pay back capital. And traditional investors are less than thrilled when facing moderate financial returns and a lack of liquid exit markets. New approaches such as *hybrid financing models* or *blended finance* are therefore necessary to allow firm mindsets to jump ship and head for more effective solutions. A recent wave of next-generation "philanthropreneurs"[16] already proves that classic philanthropy is outdated for many wealthy millennials with an entrepreneurial mindset. They look for more "hands-on" and lasting ways to engage.

When further slicing down the capital supply side, foundations, HNWI and family offices dominate the scene. Other stakeholder groups face individual barriers

[14]Global Impact Investing Network: "Annual Impact Investor Survey 2017", 2016, https://thegiin.org/knowledge/publication/annualsurvey2017

[15]Oldenburg, Felix, and Struewer, Bjoern, in Philanthropy Impact: "Full spectrum finance—how philanthropy discovers impact beyond donation and investments", 2016, http://philanthropy-impact.org/article/full-spectrum-finance-how-philanthropy-discovers-impact-beyond-donation-and-investments

[16]The designation was coined by several publications, among others: https://www.theguardian.com/sustainable-business/2014/dec/08/new-age-of-philanthropy-philanthropreneurship

to entry. Institutional investors typically can't invest as they often miss large enough investment opportunities. Corporates seem to be unprepared for impact investing and mostly refrain to Corporate Social Responsibility (CSR) activities or in-house foundations. Retail banking customers need specifically structured investment products for smaller pockets, a task that mainly falls to their banks. A paper by Bertelsmann Foundation and the University of Stuttgart (Germany)[17] tries to guide German financial institutions into developing such offerings. Yet if banks want to move to products with measurable impact and position themselves for the values of millennial customers, they need to change mindsets as well as organizational structures—a paradigm shift. Thus, to activate the retail segment on a large scale will probably take more time if left to incumbent banks alone.

In 2014, FASE prepared an in-depth analysis of the unmet investor needs in each of the major stakeholder groups. This paved the way to define a targeted approach as well as to come up with several innovative solutions. Figure 2 illustrates the main results:

The ecosystem: needs of major stakeholders not fully addressed in early-stage social finance in Germany

Investor types	Tickets (EUR k)	Return expectation			Risk potential	Financial expertise	Engagement		Currently addressed?
		Donation	Impact	Financial			Active	Passive	
1. Active social business angel	50-100		✓	✓	●	●	✓		✓
2. Passive social business angel	50-100		✓	✓	●	●		✓	✓
3. Social venture funds	250-1'000		✓	✓	◑	●	✓		(✓)
4. Private philanthropists	50-100	✓	✓		●	○		✓	✘
5. Classical foundations (PRI)	50-200	✓			●	◑		✓	✘
6. Classical foundations (MRI)	50-200		✓	✓	○	◑		✓	✘
7. Progressive foundations (PRI/MRI)	50-200	✓	✓	✓	●	◑		✓	✓
8. Public authorities	>200		✓		●	●		✓	✘
9. Institutionals	>500			✓	◑	●		✓	✘
10. Corporates	50-200	✓	✓		●	◑	✓	✓	✘
11. Banks	100-500		✓	✓	◑	●		✓	✘
12. Crowd	<200		✓	✓	●	◑		✓	(✓)

Fig. 2 The needs of major stakeholders not yet addressed in the German ecosystem for early-stage social finance (Source: FASE)

[17]Bertelsmann Foundation: "Social Impact Investment in Deutschland—Chancen und Potenziale für Banken und Sparkassen", 2016, https://www.bertelsmann-stiftung.de/de/publikationen/publikation/did/social-impact-investment-in-deutschland/

New Building Blocks

When imagining an ideal ecosystem, regulators, investors, intermediaries and investees would integrate seamlessly. Their mindsets would change to 4D, i.e. include the dimension of social and environmental impact. Institutional investors would massively join the market and account for more than 50% of it. Retail customers would have free choice of impact products for small pockets. Foundations would get rid of the habit to only give grants but invest with their capital stock or engage in blended finance solutions. Corporates would go beyond CSR and establish corporate social venture and/or investment activities. Social enterprises would be ready to scale and offer competitive risk-return assets. Banks would commit to act as facilitators and make social capital supply and demand meet. Specialized intermediaries and market places would become abundant. And the legal, tax and regulatory framework would be spotless and supportive.[18]

However, as long as this dream is not reality, much remains to be done. Figure 3 offers some findings outlined by a study by FASE, Ashoka and McKinsey on “achieving impact for impact investing”[19] in developed countries. It describes a detailed roadmap—based on the example of the German market—that includes

Fig. 3 Roadmap for concerted actions of all stakeholders to create an established social finance market in Germany (Source: FASE, Ashoka and McKinsey)

[18]See also FASE, Ashoka, McKinsey: “Achieving impact for impact investing—a roadmap for developed countries”, 2016, https://www.mckinsey.de/files/report_impact_investment.pdf

[19]See footnote 18.

concerted actions of all market participants to address the missing links in the ecosystem:

To date, FASE created several building blocks that help to positively shape the framework for early-stage social enterprise finance. The following are some examples:

Innovative Cooperation Models

Whether it is about solutions that effectively blend different types of investors, or those that combine various financing instruments to meet the needs of individual investees, *hybrid finance* is key. To date, FASE designed seven innovative cooperation models within three different groups: (i) tailored financing models, (ii) hybrid cooperation models, and (iii) innovative financing vehicles. Figure 4 gives a brief overview of these solutions. While the first two groups apply to individual transactions with just one social enterprise, the third group, *innovative financing vehicles*, aims to address market failures on a broader scale:

(i) Tailored financing models: In social finance, there is no such thing as a "one fits all" solution. Several financing instruments and additional features can help to effectively match expectations between a social enterprise and its future investors. They also allow to incentivize the enterprise for impact performance and/or to have investors participate in its profit or revenues. Smartly combined and fine-tuned, these instruments and features form tailored models that are able to meet the social enterprise's needs while at the same time satisfying a diverse mix of investor profiles. One example will be illustrated with a case study in Chapter "Understanding Sustainable Finance".

(ii) Hybrid cooperation models: There is often a rift between different types of funders from various financing planets. To effectively combine these "species" in one transaction was the driver to develop this specific group of models. Philanthropic or crowd funders are bundled with impact investors to create a hybrid cooperation model for the benefit of better social enterprise finance.

Fig. 4 Innovative cooperation models developed by FASE (Source: FASE)

Details to this group of models as well as several case studies are available in a special report issued by FASE in 2015.[20]

(iii) Innovative financing vehicles: Systematic gaps in the social finance market call for broader and more diversified solutions. One of them is an *early-stage co-investment fund*. It aims to solve the lack of early-stage finance for social enterprises in Germany and Austria and thereby reduce the risk that the pipeline for later-stage investees will dry out. To be effective and appealing, such a vehicle needs a high-quality deal flow of investment-ready enterprises and a smart design of the underlying fund economics. FASE initiated the fund to become a diversified portfolio of social enterprise investments that are linked to FASE's pipeline of transaction support mandates. The fund will invest at the identical terms and conditions defined by the lead investors of each transaction ("pari-passu") while being passively managed to create an attractive economic profile for fund investors. This project is currently in the stage of marketing. More information to the design of the second solution, the *non-profit investment vehicle*, can be found in the above-mentioned report.

New Pay-for-Success Solutions

Another important building block are innovative *pay-for-success models (PFS)*. In general, they incentivize investors or social enterprises by providing payments for positive social and measurable outcomes achieved. New PFS solutions are especially relevant for social enterprises that operate in market areas where it is almost impossible to establish business models that can structurally reach break-even (e.g., early-child programs). Here, "classical" repayable financial instruments cannot be leveraged for further growth. Since government funding for social welfare services diminishes, there has been considerable attention for this new approach.

As opposed to another PFS model, the *Social Impact Bond (SIB)*, recent solutions are less complicated and more direct since they remunerate the social enterprise—not the investors—for the achievement of pre-defined outcomes. The plan of FASE is to design and pilot rather small and lean PFS projects where a private philanthropists or foundation assumes the role of the outcome payer. In the case of SIBs, this role typically falls to governmental bodies. One example of a recent innovation are *Social Impact Incentives (SIINC)*.[21] This is a catalytic instrument created by *Roots of Impact* and the Swiss Agency for Development and Cooperation and specifically designed for bringing together high-impact social enterprises, impact investors and public or philanthropic funders. SIINC is planned to be part of the pilots mentioned above. Concrete discussions with suitable social enterprises in Germany are ongoing.

[20]FASE: "Creating Collaborative Funding Models for Social Enterprises—a final report by the Financing Agency for Social Entrepreneurship (FASE) on a project mandated by the European Commission", 2015, https://77cf4b2b65d8e527a5ddcb5f-piconda.netdna-ssl.com/static/uploads/sites/225/2015/12/FASE-Final-Report-EU-Project-July-2015.pdf

[21]More information under http://www.roots-of-impact.org/siinc/

Other activities of FASE to build the ecosystem for social enterprise finance stretch beyond these models.

Hybrid Models in Practice

The Importance of Hybrid Models

Models that are able to combine different types of investors, risk-return-impact profiles, financing instruments, impact incentives and/or various requirements on the part of the investees are important in today's ecosystem. To make the right funders match with the right social enterprises, highly tailored individual transactions are a very effective means to improve the social finance ecosystem.

Beyond the existing hybrid models designed, there are a number of ideas and innovations that have the potential to further improve the state of play. They can be grouped in two basic categories: (1) de-risking, and (2) boosting financial returns.

For category (1), philanthropic funders such as foundations, donor organizations, private philanthropists or governmental bodies play a vital role. By providing grants or guarantees for social finance transactions that would otherwise fail to attract investors due to high risk, such donors are able to improve the risk profile of investees and mobilize more private investment. Typical applications for this type of *catalytic capital* are first-loss capital/junior loans, or loss guarantees such as the EaSi guarantee program of the European Commission.[22]

The previously described pay-for-success solutions fall under category (2). By monetizing social outcomes achieved, high-impact transactions are becoming financially more appealing to investors.

The following case is an example of a hybrid model applied to an individual transaction with a social enterprise. Here, several financing instruments and additional features were smartly combined to tailor the transaction to the needs of the target investee and its investor(s). The transaction was successfully closed in 2015 with the support of FASE.

Case Study Disability Performance (DP)

DisAbility Performance (DP)[23] is a social enterprise founded by Ashoka Fellow Gregor Demblin with the vision to create a barrier-free economy. Around 630,000 people in Austria are disabled or have special needs. Yet only 40% of them are actively participating in the labor market. Companies do not yet recognize disabled

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[22]More information: http://www.eif.org/what_we_do/microfinance/easi/

[23]http://www.myability.org/

people as a specific customer group and therefore lose billions of EUR due to unused talents and unserved clients. For disabled people, this structural weakness leads to an exclusion from society and an inability to lead a life based on equal rights and opportunities. Many of them are willing to work and to consume, but they are underestimated due to a perceived lack of competences or deeply rooted prejudices. Simultaneously, their numbers are growing as a consequence of demographic change. The problem is therefore not a social burden but an economic challenge that has to be addressed by the economy itself.

The Solution

DP solves the problem by positioning itself at the gateway between economy and people. It is an innovative social consultant supporting corporate players to understand and identify the potential of people with disabilities as future employees and clients. At the same time, it connects best practice companies with each other in order to facilitate a knowledge transfer within the economy. The idea is simple: an ageing society will see an increasing number of people with special needs. If companies are able to build the necessary knowhow and flexibility to make use of this potential, they will be well equipped to cope with fundamental changes. To succeed in this, all corporate divisions need to be involved: from recruiting and design of work spaces, to products and services, barrier-free construction and management strategy. Since many companies already have initiated excellent projects for disabled people, one of the main tasks of DP is also to increase visibility and to promote best practice examples through an economy-wide knowledge exchange.

The Social Entrepreneur

Gregor Demblin was born in 1977 and sits in a wheel chair following an accident. In 2009, he co-founded Career Moves, a non-profit company that successfully integrates disabled people in the labor market. The company received many awards, among others the First European Award for Social Entrepreneurship and Disability, and is considered to be a unique light house project across Europe. Gregor is an Ashoka Fellow, a Global Associate of the Business Disability Forums UK, and an internationally renowned expert in the field of economy and disability. With the establishment of DP, he built on his substantial experiences with Career Moves by meeting the needs of corporates for a professional disability consulting.

The Financing Model

DP operates as a for-profit limited liability entity which receives payments for its consulting and networking services. As a consequence, there is an opportunity for a financing model that is sustainable and secure. To build DP, the company needed EUR 330,000. After the necessary repayments to the investors, future profits will be used to fuel the company's growth and to scale its proprietary non-profit job platform Career Moves. The financing model uses quasi-equity, i.e. *mezzanine capital with revenue participation and social impact incentive ("model 1")*. The basic ingredients and characteristics of this model can be described as follows:

Quasi-equity without loss participation is combined with a revenue share. This share comes as a maximum percentage plus a fixed return. The basic intention is to

define a target return for the investors but to cap the amount of the revenue share in the beginning. This enables the social enterprise to develop its business first, without initially paying too much for the freshly raised capital. A typical mechanism to achieve this is to set a cap. This cap is a certain percentage on the nominal value of the investment amount. Each year, revenue share and cap are compared. If the cap is lower, then the investors receive the lower payment but are entitled to catch-up on their claims in future years so that they are finally able to achieve the target return.

The effect of such a model is positive: the burden of the social enterprise to meet the investors' return claims is partly postponed to a later point in time when the company is more developed. This illustrates why such financing structures are often called "patient capital": they give the company leeway to focus on growth for a certain number of years. Another important twist to this model is that it includes incentives for the enterprise to meet their social and/or ecological impact targets. Impact investors are ready to waive a certain part of their target returns if a pre-defined impact goal is fulfilled. These impact goals are typically defined by quantity and by timing. Altogether, this is a model that provides the necessary flexibility to the social entrepreneur while making sure that investors are rewarded appropriately with respect to financial return as well as social impact.

The Investors

In 2014, FASE approached almost 120 investors with the opportunity to provide growth capital to DP. In the course of the transaction process, the group of interested investors was narrowed down to four–two business angels, one bank and an institutional social venture fund. All of these went through detailed discussions and management presentations. At the end, the social venture fund decided to provide the entire financing amount. The term sheet was signed and the transaction successfully closed in March 2015.

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