EUROPEAN VENTURE PHILANTHROPY ASSOCIATION

A PRACTICAL GUIDE TO VENTURE PHILANTHROPY AND SOCIAL IMPACT INVESTMENT

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A PRACTICAL GUIDE TO VENTURE PHILANTHROPY AND SOCIAL IMPACT INVESTMENT

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EVPA is very grateful to all those members who have shared their insights, successes, failures and learnings with the wider community of VP/SI practitioners, in particular Deirdre Mortell, Pieter Oostlander and Luciano Balbo, three practitioners who wrote the first edition and have been instrumental in shaping this updated Guide. We would also like to thank all the people who contributed to the first edition: Artur Taevere as a peer reviewer, Cormac Sheridan as editor and the project manager Ahmad Abu-el-ata. We are also thankful to the people who peer reviewed the second edition: David Carrington, Inês De Oliveira Magalhães and Nat Sloane for their support, as well as Emilie Goodall (Bridges Ventures) and Chloe Tuot (PhiTrust) for the feedback on specific parts.

Foreword

Setting up anything new takes courage and tenacity, and making it a success will require skills and networks too. This applies to a Venture Philanthropy Organisation as to anything else. Three of our authors (Balbo, Mortell, and Oostlander) took this step into the unknown approximately ten years ago, developing our work through trial and error, and seeking the experience of others in other countries as much as we possibly could. That really helped.

That's why five years later, in 2008, we decided to try to document what we had learned, in order to help others to benefit from our experience, but also to contribute to the development of practices, including best practices, and to start debates about what best practice should look like?

Practices and debates developed so quickly across the industry in Europe, including the development of the social impact investment industry, that we felt the need to revise the report with a 2010 edition.

Now in 2016, EVPA's Knowledge Centre is well equipped to draw from a wide range of experience and practice across many European countries, as venture philanthropy and social impact investment are now well established paths to driving social impact.

This very practical guide aims to inform and assist practitioners on how to maximise the impact of their financial and non-financial investments, whether they are made as grants, loans or equity. It aims to assist those who are considering starting a new organisation, but also the many existing practitioners, with information on how others are doing it and what industry standards look like as they begin to emerge.

Venture philanthropy and social impact investment are still young industries and will be for some time to come, so there is plenty of room for change and innovation. Most importantly, we must remember that we are in the business of taking risk, in order to support a step change in social impact. As innovation and failure are two sides of the same coin, venture philanthropy and social impact investment will experience failures as well as successes. We hope this guide will help practitioners to withstand these failures. The only true failure is failure to learn.

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Executive Summary

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This is the third edition of a working paper that was first published in 2008. It was intended to capture and share the learnings of a number of pioneer European Venture Philanthropy (VP) Organisations (VPOs), which were set up in the period 2000–2004, when the VP 'movement' first began in Europe. The third edition of the report also incorporates the learnings of five years of research performed by EVPA's Knowledge Centre on topics such as impact measurement, exit strategies, non-financial support and learning from failures, and presents a snapshot of the sector based on data from EVPA's Industry Survey.

The goal of this practical guide is to assist start-up or early-stage VPOs in Europe by providing an insight into 'what works' in a European context, keeping in mind the diversity existing at individual country level. At the end of the document, there is a glossary that provides definitions of the key terms mentioned in the report.

VP is simply one tool in the philanthropy toolkit. It has emerged in Europe during the present decade as a high-engagement approach to grant-making and social impact investment (debt, equity, etc.) across a range of Social Purpose Organisations (SPOs), from charities and non-profit organisations through to socially driven businesses. Venture philanthropy works to build stronger SPOs by providing them with both financial and non-financial support in order to increase their social impact. The methodology is based on applying venture capital principles, including long-term investment and hands-on support, to certain elements of the social economy. The key characteristics of venture philanthropy include:

- Tailored financing using a variety of financial instruments (including grant-making and social investment)
- Organisational support to help SPOs build strategic and operational capacity
- An emphasis on impact management (at both SPO and VPO levels)

The VP industry seeks to complement existing forms of social finance and to contribute to the development of a more efficient capital market to support the social sector. Although VPOs initially adapted high-level principles from investment industry players such as venture capital funds, they have since developed specific investment tools, processes and methodologies that have been adapted to work effectively in the social sector. Venture philanthropists with roots in the commercial sphere have had to learn how to operate within the cultural and operational frameworks of the social sector.

Setting up a VPO

Before setting up a VPO, consideration should be given to the type of **funding models** that will be applied. The main question to be answered is whether the VPO will act as a social investor or focus on grant funding of target SPOs. In many European countries, tax and legal regulations distinguish between grant funding, and instruments that establish ownership titles, and the legal structure of the VPO has to take such regulations into account.

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The success of any new VPO will be driven by the **founder(s)**, who will define a vision and a set of objectives for the organisation. Founders typically come from either the world of private sector investment or from the social sector. A successful VPO needs to possess skills from each of these areas in-house. The founder therefore needs to attract the right start-up management team – particularly the right **CEO** – to build the organisation's knowledge and expertise.

VPO **management teams** are often small at start-up – typically one to four people. Ideally, they should comprise open-minded individuals who share the founder's vision and passion for social change and who are willing to acquire new skills in what is a rapidly evolving industry. The VPO shall recruit from both the private and the non-profit sector. Working in this sector brings VPO staff often coming from a commercial background into close proximity with SPO staff with non-profit experience, so openness, curiosity, patience and humility are necessary. Remuneration levels in the VP sector are sometimes set at discount to the private sector, accounting for the 'social return' enjoyed by staff through their work and compensating through improved working conditions. Currently, attracting and keeping the right talent is a crucial challenge in the industry; attracting good professionals calls for new and improved incentive structures, capable of competing with the commercial sector.

A VPO's **board** can fulfil various roles, depending on needs. They are likely to have external duties, such as fundraising and public relations, as well as internal obligations, such as providing expertise and support to the management team. At start-up, a VPO will typically have a small (three-to-five member) hands-on board, who engage actively with the management team. The decision-making practices have evolved in the past years, and currently three models exist of how to involve the investors in the investment decision through the investment committee: (i) the management-driven model, where the fund management team makes the investment decision, independently from the board; (ii) the mixed model, where subsets of the investors are involved in the decision-making process at different levels; and (iii) the investor-driven model, where the investment committee is composed of investors.

Fundraising is a key challenge for any start-up VPO. It requires vision, clear communication, persistence, passion and optimism. Prospective funders are likely to fall within one of a number of categories, such as the founder's personal network, existing trusts and foundations, high-net-worth individuals, corporates and government agencies. It is worth taking time to understand which investors will share the founder's vision, and approaching them accordingly. The VPO should not try to bend its investment strategy to the needs of potential funders, but reach out to funders who have the same vision and goals. Due to the relative immaturity of VP, the founder will need to communicate the vision clearly to potential investors, the investment model and goals. They will often need to be introduced to the principles of VP and to be convinced of VP funding's great potential to deliver social impact. Having a high-calibre CEO in place and identifying a handful of initial high-quality SPO investments can help build credibility and encourage commitment from investors.

VPOs that do not have an endowment need to raise a follow-on fund when the first fund has been invested. At this time, successful VPOs have the advantage of having developed a track record of effective investment in a number of SPOs which may facilitate further fund-raising. However, in some cases, follow-on funding may be harder to obtain since start-up funders, especially foundations, often feel their support role becomes less necessary for successful and established VPOs. After the first five years of operation, and depending on the results it has achieved to date, the VPO may consider whether to adapt any of its headline objectives (e.g. adopting a narrower sector focus on areas that have delivered the most social impact). Adding peripheral activities, finding ways to recycle capital and generating economies of scale in the management fee are different ways of sustaining the structure of the VPO.

Investment strategy

The starting point for developing an investment strategy lies in a clear articulation of the VPO's social and financial objectives. The first step is to define the VPO's own Theory of Change, i.e. the social problem(s) it wants to address and a strategy of how to improve the situation through its investments. Some VPOs are pure grant-makers and do not seek a financial return whereas others act as social investors with different degrees of return expectations. The investment strategy encompasses a possible sector and geographical focus, the preferred type(s) and development stage(s) of SPO (i.e. start-up/early-stage/more established organisations) and the financial instruments used. It also includes the co-investment policy and key considerations around the VPO's impact measurement and management system, the organisational support it will provide, and its exit strategy.

When choosing the **geography** and **sector** it wants to be active in, the VPO needs to consider that having a narrow geographical and sectoral focus helps accumulating specific knowledge through which the VPO can support the SPO more efficiently and generate and demonstrate more impact.

VP is most appropriate as a source of finance and support to SPOs that are seeking a 'step change' in their operations. For small and medium-sized SPOs, this may mean replicating their operating model in new or more broadly defined markets. For larger, more established SPOs, VP funding may be appropriate in several settings that involve managing change, such as mergers and scaling up. VP is not necessarily appropriate for all SPOs.

The preferences and requirements of the fund's investors will determine the fund's term. Its 'tools of the trade' will also need to be defined, namely the **financial instruments** that will be used. VPOs can employ a wide range of instruments, including guarantees, loans of various levels of seniority, quasi-equity, equity and grants. The sector is in continuous evolution, thus new financing instruments are constantly being developed. The choice of

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instrument will be driven by the particular circumstances of the SPO and the investment. Instruments that require repayment, such as loans or quasi-equity investments, are best suited to income-generating SPOs.

Co-investment should be seen as a key part of the investment strategy. It is an excellent way of generating additional funds for SPOs and bringing varied expertise and a larger network. Moreover, it can offer the VPO itself an easier route to obtaining finance than direct fundraising and decrease risk across investors. It can also help to communicate the VP approach to the broader funding community (e.g. through co-investment with foundations or trusts). It is important to agree on roles, responsibilities and obligations with co-investors at the outset, to avoid the risk of misalignment of objectives among co-investors (i.e. social impact and financial return objectives). The VPO – which is most actively engaged with investee SPOs – will generally act as lead investor.

As part of the investment strategy the VPO should consider the possible forms of **Non-Financial Support (NFS)** to offer to the SPOs it finances. Following the five-step process envisaged by EVPA[1], the VPO decides what type of NFS is core or non-core to its investment strategy, and who provides each type of support, based on a mapping of its assets. The VPO should provide the core support through its own staff and can offer the non-core support through external experts working pro bono, at reduced rates (low-bono) or on a fully commercial basis. The purpose of any organisational support should be agreed in advance with the SPO. The non-financial support offered aims at strengthening the SPO's social impact, financial sustainability and organisational resilience. The VP approach puts particular emphasis on the topic of societal impact and thus on impact measurement. Given the **centrality of impact measurement and management**, when developing its investment strategy a VPO should take into account how it will measure social performance during each step of the social impact investment process. However, measuring social impact can be difficult, as it is often hard to quantify objectively. EVPA in its "*A practical guide to measuring and managing impact*" has devised a five-step framework to guide VPOs in developing an impact measurement process[2]. We recommend a detailed reading of that report to fully understand how to implement impact measurement. As part of the investment strategy, the VPO articulates its own Theory of Change, which will guide it in the selection of the SPOs to invest in, and identifies and engages the key stakeholders, to guarantee they understand and support the VPO's impact objectives.

Lastly, the VPO defines its **exit strategy**, i.e. the action plan to end the relationship with the investee in such a way that the impact is maintained or amplified, or that the loss of social impact is minimised. As recommended by EVPA's report "*A practical guide to planning and executing an impactful exit*"[3], the VPO needs to consider which elements of its investment strategy will affect all its future exits, and how.

1. **Boiardi, P.,** and **Hehenberger, L.,** (2015), "*A practical guide to adding value through non-financial support*", EVPA.
2. **Hehenberger, L., Harling, A.,** and **Scholten, P.**, (2015), "*A practical guide to measuring and managing impact - Second Edition*", EVPA.
3. **Boiardi, P.,** and **Hehenberger, L.**, (2014), "*A practical guide to planning and executing an impactful exit*", EVPA.

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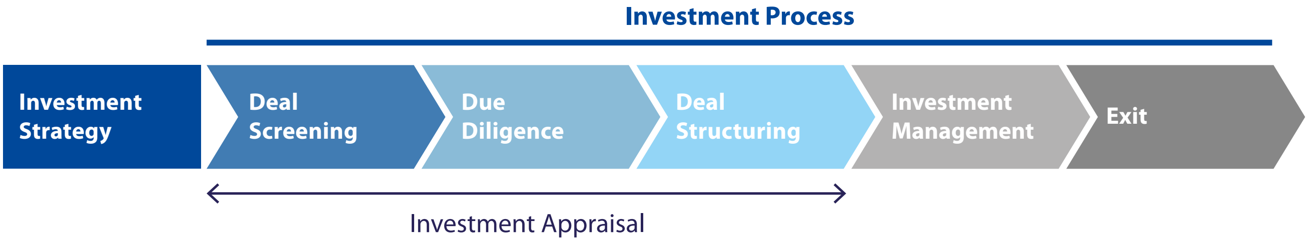
Investment process

For each investment the VPO goes through an investment process, as outlined below.



Through the investment process the VPO maximises its impact objectives, guaranteeing that its (scarce) resources are invested in the most impactful way.

The **investment appraisal** is made up of three phases: deal screening, due diligence and investment selection, and deal structuring.

VPOs tend to take a proactive approach to identifying potential investee SPOs. It can be more focused and efficient than accepting open applications since VPOs target a very specific type of SPOs, and does not impose the administrative burdens associated with the latter approach. Potential organisations can be identified directly or via the VPO's own network (e.g. existing portfolio SPOs, networking with intermediaries and other funders or co-investors) or through conferences or business plan competitions. Leveraging the network of established investors and co-investors can be an excellent way of generating high-quality deal flow. This is especially important at start-up, when securing some early wins will be important (this may also necessitate an initial focus on lower-risk investments). Generating good deal flow will also require communicating the principles and benefits of VP to target SPOs, who may be unfamiliar with the concept.

The impact objectives of the VPO guide it through the deal screening phase, a knock-out screening step for all applicants who do not meet the standard application criteria. During the deal screening, the VPO will:

- Assess whether the investment opportunity fits with its own strategy and contributes to achieve its own impact objectives
- Perform a 'light' assessment of the needs of the SPO, to see whether there is an initial match between the non-financial support the VPO can offer and the non-financial support needed
- Be guided by the key exit considerations, as derived from its investment strategy.

During the **due diligence** phase the VPO assesses in more detail whether there is an alignment between the VPO's and the SPO's objectives, performs an in-depth needs' assessment

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to assess whether the SPO's needs in terms of non-financial support match what the VPO can offer and starts looking into how to plan for the exit.

An organisation that has passed the deal screening will generally build a business plan, as the 'output' to the detailed screening step. Typically, this includes a review of the organisation's market, its three- to five-year strategy and operational plan, its social impact targets and impact measurement system, a financial budget, an outline of its governance and organisational structures and an assessment of its management and board capability. Although the business plan should be seen to be 'owned' by the SPO, a VPO will often support its development, either directly or by providing third-party consultancy support.

The investment proposal that emerges from the planning phase will consist of the business plan (or a presentation of the business plan) and an accompanying commentary that considers investment-related issues, such as risk appraisal, stepped investment plans (to limit risk and to base future funding on performance), level of engagement during the investment phase and exit options.

When the **investment decision is taken** and the **deal is structured**, the VPO needs to decide with the SPO:

- *The non-financial support plan*, including the SPO`s objectives in terms of societal impact, financial sustainability and organisational resilience (each having a baseline, a goal, a milestone and a target outcome), what services will be provided, by whom and when and the resources and responsibilities for what concerns measurement;
- *The exit plan*, which includes the goals of the VPO and SPO, the timing and mode of exit, the resources for the exit plan and the exit market scenarios.

Once the deal has been signed the **investment management** phase starts.

VPOs typically have a small portfolio of investee SPOs, reflecting the high-engagement nature of the investments. However, VPOs need to have a minimum size of portfolio to guarantee a sufficient spread of the risk and to demonstrate VP works in a number of circumstances. The 'right' portfolio size will depend mainly on the size of the VPO, the average size of a single investment and the level of non-financial support offered. When deciding on the portfolio size, VPOs should also consider the optimal portfolio size required to create a network of dialogue and collaboration between the SPOs, thereby creating an opportunity for incremental impact.

Various portfolio management options exist, including taking a board seat and arranging regular reports and reviews. Where possible, the form, frequency and purpose of engagement between VPO and SPO should be agreed and documented in an investment agreement.

During the investment management phase the VPO monitors the achievement of its own social impact and financial return goals. The VPO delivers the non-financial support and monitors the achievement of the goals set in the non-financial support plan, in terms of social impact, financial sustainability and organisational resilience. Finally, thanks to the monitoring of the investment plan, the VPO can assess if and when exit readiness is achieved, and take corrective actions in case of deviations from the original plan.

In cases where investments do not succeed initially, the VPO should evaluate the reasons for failure and help investees find solutions to problems where possible. Funds should avoid the temptation to simply throw money at the problem. Often, an SPO in difficulty may require non-financial assistance, such as staff coaching and even moral support for its leadership team. The most appropriate form of support will depend on the specifics of a given situation.

The ultimate goal of portfolio management is to maximise the VPO's overall social impact. Portfolio SPOs will inevitably compete with each other for the limited financial and non-financial resources that are available. In managing this dynamic, the VPO will have to keep sight of its strategic goals. But by investing in complementary – rather than competing – SPOs, VPOs can at least create additional leverage and impact by facilitating collaboration and knowledge-sharing among investees.

At the time of **exit**, the VPO determines how to exit (mode of exit) and whom to exit to (follow-on investors), balancing the financial and social return. The final goal of the exit is for the SPO to maintain its social impact nature; therefore, the VPO will need to make sure the follow-on funder's strategy matches the needs of the SPO both in terms of financial and non-financial support offered. If the SPO is self-sustaining, the VPO does not need to find a follow-on funder, and the investee can continue on its own.

The mode of exit will vary based on the funding instrument used (grants versus other funding instruments), the context and the stage of development of the SPO.

In the unfortunate case in which the investee is not performing (and the VPO does not see a future for the investee), the VPO can also decide to let go, and the SPO may need to shut down its operations. This shall not be considered as an exit but as a case of failure, which the VPO will need to analyse in detail to distil the main lessons for its future investments.

Once the exit is completed the VPO can engage in post-exit activities, which include:

- *Evaluation* – The VPO needs to perform an overall evaluation of the investment, which includes an assessment of the value and impact of non-financial support, an assessment of its own achievements in terms of social impact and financial return (if foreseen) and an assessment of the overall exit.
- *Post-exit activities* – The VPO can decide to keep in touch with its investees after exit, by means of networking events, offering additional non-financial support or by organising "Alumni" networks. All these activities have as main objectives avoiding mission drift and monitoring the impact achieved by the SPO.

Part 1:

Introduction

INTRODUCTION

1.1 Purpose of the document

This report provides concrete guidance to organisations that are getting started in venture philanthropy and social impact investment in Europe. It builds foremost on an earlier report called *"Establishing a Venture Philanthropy Organisation in Europe"*[4] that was first published in 2008, with a second edition in 2010. Therefore, it includes the experience of some of the pioneer Venture Philanthropy Organisations (VPOs) that were set up in the period 2000–2004, when the VP 'movement' first began in Europe. However, this new version also incorporates the key learnings from EVPA's Knowledge Centre publications on the constituent practices of venture philanthropy, including impact measurement[5], exit strategies[6] and non-financial support[7] and the report on learning from failures[8], on specific target groups such as foundations[9], as well as on EVPA's industry surveys[10] that capture data on an annual basis on the VPOs based in Europe. Specifically, for the three reports on impact measurement, exits and non-financial support, the main recommendations have been integrated as part of the investment strategy and investment process.

The VP approach includes social impact investment and grant-making best suited to support organisations seeking innovation and scale of impact by adopting a long-term, strategic view of growth. VP is not suited to a significant portion of the social sector market, for example community-oriented organisations working within relatively stable, unchanging environments. VPOs are usually interested in implementing a change process such as geographic expansion or transition to an income-generating Social Purpose Organisation (SPO), in order to achieve a strong societal impact. The report also documents the cases where there are clear differences in the VP approach between grant-making and social impact investment – the latter using a number of financing instruments allowing for a positive financial return.

We also document further VPO experience in the spheres of managing/creating deal flow; pursuing follow-on funding beyond the start-up phase; developing different vehicles (i.e. co-investing, specialist funds, etc.) and the greater need for portfolio management rather than just individual investee management due to increased portfolio size.

Lastly, the financial crisis has produced material change in the financial and economic climate. Implications for VPOs are reflected in the incremented challenges of attracting start-up funding; the possible demands of new funders to the sector seeking financial return; the shrinking levels of public sector funding that can form a part of both the VPO's funding base and the income streams of the SPOs themselves and can affect the risk profile that VPOs accept.

The learning and recommendations set out here reflect the experiences of VP practitioners. This document is not intended as an academic paper. Rather, it is best considered as a milestone on a learning journey. We expect and hope that the content will date quickly, as the European venture philanthropy movement gains scale and momentum, and surpasses the

4. **Balbo, L., Hehenberger, L., Mortell, D.,** and **Oostlander, P.,** (2010), *"Establishing a Venture Philanthropy Organisation in Europe: A Practical Guide"*, EVPA
5. **Hehenberger, L., Harling, A.,** and **Scholten, P.,** (2015), *"A practical guide to measuring and managing impact – Second Edition"*, EVPA.
6. **Boiardi, P.,** and **Hehenberger, L.,** (2014), *"A practical guide to planning and executing an impactful exit"*, EVPA.
7. **Boiardi, P.,** and **Hehenberger, L.,** (2015), *"A practical guide to adding value through non-financial support"*, EVPA.
8. **Hehenberger, L.,** and **Boiardi, P.,** (2014), *"Learning from failures in Venture Philanthropy and Social impact investment"*, EVPA.
9. **Metz Cummings, A.,** and **Hehenberger, L.** (2010) *"Strategies for Foundations: When, why and how to use Venture Philanthropy"*, EVPA.
10. **Hehenberger, L., Boiardi, P.,** and **Gianoncelli, A.,** (2014), *"European Venture Philanthropy and Social Investment 2013/2014 – The EVPA Survey"*, EVPA.

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experience documented here. Some of the views expressed here are shared across VPOs, others are not. Where views diverge, we have tried to present several perspectives and outline the circumstances in which they may apply. In this third edition of the paper, we have tried to incorporate some of the comments we have received on the second edition. We envisage future editions of this document and continue to welcome your views and perspectives to grow the body of practice recorded here. Please email your comments to info@evpa.eu.com.

We wish for this report to become a point of reference for practitioners who are exploring the possibility to enter the Venture Philanthropy/Social Impact Investment (VP/SII) space as well as a document used to introduce VP/SII to an increasing number of practitioners.

The document is structured as follows. Part One defines Venture Philanthropy and outlines how the VP approach came to being and evolved in Europe in the past decade, highlighting the main difference between grant financing and social impact investing.

Part Two then looks into the main issues to face when setting up a Venture Philanthropy Organisation, namely: the funding model, the organisational structure and fundraising, highlighting challenges and recommendations on how to successfully set up and run a VPO.

Part Three focuses on the investment strategy, guiding the VPO in making choices on geography and sector of intervention, type of SPO supported, etc.

Part Four then looks at how the investment strategy is implemented through the investment process, focusing on best practices (also derived from five years of EVPA's Knowledge Centre research on VP's best practices) pointing to the main issues that can arise when making an investment.

Part Five concludes, highlighting the challenges for the future of the VP sector.

1.2 Essence and role of Venture Philanthropy

Venture philanthropy (VP) provides a blend of funding and professional services to social purpose organisations – helping them to expand their societal impact. This is a high-engagement, partnership approach, analogous to the practices of venture capital in building the commercial value of young companies. VP in its modern form developed originally in the US in the mid-1990s, took hold in the UK from 2002 and has since expanded into continental Europe[11].

1.2.1 Definition of Venture Philanthropy

VP is a high-engagement and long-term approach to generating societal impact through three core practices:

- **Tailored financing**: Using a range of financing mechanisms (including grants, debt, equity hybrid financing) tailored to the needs of the organisation supported.

11. **John, R.,** (2006), *"Venture Philanthropy: the evolution of high engagement philanthropy in Europe"*, Skoll Centre for Social Entrepreneurship, Said Business School, University of Oxford.

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- **Organisational Support:** Added-value support services that VPOs offer to investees (SPOs) to strengthen their organisational resilience and financial sustainability by developing skills or improving structures and processes.
- **Impact measurement and management**: Measuring impact and managing the process of creating social impact in order to maximise and optimise it.

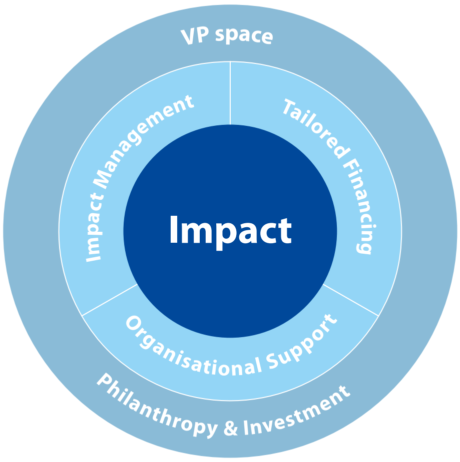

Figure 1:
Key characteristics of Venture Philanthropy

Source: EVPA

Taking into account the three characteristics above, it is possible to define the actors who are inside or who are outside of the Venture Philanthropy tent in Europe. Meeting these categories is the most relevant aspect to be considered a VP practitioner, even more important than the financing instruments used or the type of organisations supported[12].

Venture philanthropy works to build stronger investee organisations by providing them with both financial and non-financial support (including organisational support and impact management) in order to increase their societal impact. EVPA purposely uses the word "societal" because the impact may be social, environmental, medical or cultural. 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. The investee organisations may be charities, social enterprises or socially driven commercial businesses, with the precise organisational form subject to country-specific legal and cultural norms.

The Venture Philanthropy/Social Impact Investment (VP/SII) organisation acts as a vehicle, channelling funding from investors and co-investors and providing non-financial support to various investee organisations. The non-financial support is provided by the VP/SII organisation itself, but also by external organisations and individuals. The investee organisations in turn develop multiple projects that may be focused on particular sectors, such as healthcare, education, environment, culture, medical research. The ultimate beneficiaries are usually groups in the society that are somehow disadvantaged, such as disabled, women, children. The societal impact ultimately needs to be measured by assessing how

12. **Buckland, L., Hehenberger, L.,** and **Hay, M.,** (2013), *"The Growth of European Venture Philanthropy"*, Stanford Social Innovation Review.

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the lives of the beneficiaries are improved thanks to the actions of the investee organisations, and, going one step further, assessing the contribution of the VPO to that improvement. The VPO generates social impact by building stronger investee organisations that can better help their target beneficiaries and achieve greater efficiency and scale with their operations. Investors in VP/SII are usually focused on the social return of their investment, rather than on the financial return.

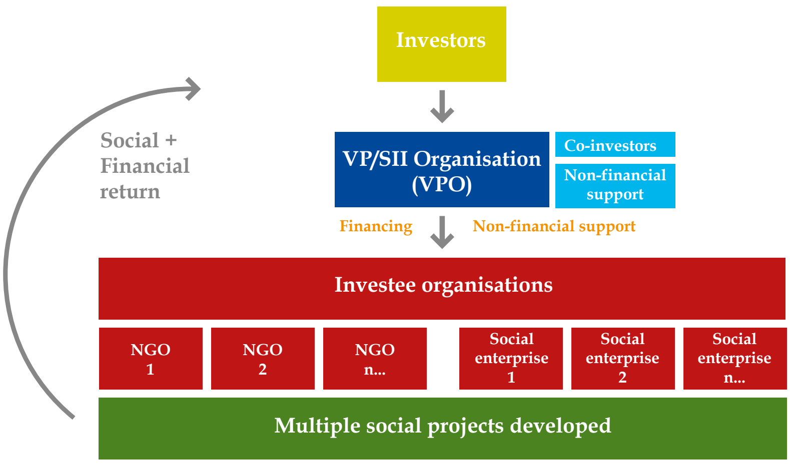

Figure 2:
Venture Philanthropy model

Source: EVPA

1.2.2 Origins and European expansion

The term 'venture philanthropy' can be traced back as far as the 1960s in the US, but it was only during the 1990s that the term gained popularity and stimulated a debate on new forms of highly engaged grant-making by foundations. An influential Harvard Business Review paper by Letts, Ryan and Grossman[13] challenged foundations to employ tools from venture capital to invest in the organisational, rather than the programmatic, needs of social purpose organisations. Porter and Kramer[14] subsequently challenged foundations to create greater value and to act as more than a passive conduit for transferring finance from private sources to grantees. At the same time, existing foundations were considering how to change some of their practices in order to better assist the social sector and how to align their investments with their social mission. In the UK, considerable interest in innovations in social impact investment, including high-engagement models, began to develop in 2001. While there were several historical examples of VP-like activity, it was not until 2002 that the UK's first VPO, Impetus Trust, was launched. In continental Europe, there has been a slow, but steady arousal of interest in social impact investment and high-engagement models of philanthropy, but only in the mid-2000s did new organisations or models emerge and the VP 'movement' actually began.

In the first phase[15] of the European VP movement – which can be dated between 2000 and 2004 – it was mainly business entrepreneurs and professionals from the private equity and venture capital world who set up the first venture philanthropy funds. An example

13. **Letts, C., Ryan, W.,** and **Grossman, A.,** (1997), *"Virtuous Capital: What Foundations Can Learn from Venture Capitalists"*, Harvard Business Review.

14. **Porter, M.E.,** and **Kramer, M.R.,** (1999), *"Philanthropy's New Agenda: Creating Value"*, Harvard Business Review.

15. **Buckland, L., Hehenberger, L.,** and **Hay, M.,** (2013), *"The Growth of European Venture Philanthropy"*, Stanford Social Innovation Review.

is BonVenture, established in 2002 in Germany by Erwin Stahl from the finance sector and funded by a few wealthy German families, and Oltre Venture set up in Italy by Luciano Balbo in 2002.

It was only during the second phase between 2004 and 2008 that venture philanthropy began attracting the attention of the existing European charitable foundations, such as the King Baudouin Foundation, in search for new ways to better assist the social sector. Since then, foundations have been increasingly interested in the VP approach as an additional tool in their philanthropy toolbox. Some foundations started using selected parts of the VP approach in their everyday activities, others set up dedicated VPOs within the foundation, and some foundations started using VP as an alternative strategy calling for a complete turnaround. Co-investment between a VPO and a foundation also emerged as an interesting strategy enabling each party to contribute its own expertise. Foundations often have extensive experience of working in particular social sectors that can prove invaluable to a VPO that is more focused on developing processes and building strong organisations[16].

In the third phase between 2008 and 2012, European venture philanthropists developed hybrid practices that were a bricolage of existing practices in the finance industry and the non-profit sector moving philanthropy into an age where sector boundaries are blurring.

More recently, what had been called social investment that started in the UK became rebranded as social impact investment, and gained momentum with the work of the Taskforce on Social Impact Investment established by the G8 under the UK presidency, involving both sector representatives and government officials. The Taskforce released its reports in September 2014 with highly relevant policy recommendations to build a stronger social impact investment market[17]. In this phase, governments and large corporations also began to experiment with venture philanthropy practices, adding two important sectors to the mix of actors. EVPA published a report on VP strategies for corporates in May 2015. The report shows the immense potential for social change there is in a strong collaboration between VPOs and corporations where VPOs bring their experience, knowledge, skills and risk-taking social impact investment approach to the table, while corporates bring significant resources, solid structures and scaling opportunities. This collaboration is already happening with very positive results, but much more can be done[18].

Today, VP is a growing force in Europe. The amount of money invested is increasing as is the number of funds and organisations devoted to this approach in different regions of Europe (see Box *"VP/SII industry by the numbers"*).

16. **Metz Cummings, A.,** and **Hehenberger, L.,** (2010), *"Strategies for Foundations: When, why and how to use Venture Philanthropy"*, EVPA.
17. http://www.socialimpactinvestment.org/
18. **Varga, E.,** (2015), *"Corporate social impact strategies – new path for collaborative growth"*, EVPA.

INTRODUCTION

VP/SII Industry by the numbers: from the EVPA Survey 2013/2014[19]

Figure 3:
VP growth

n=86

Source: EVPA Industry Survey 2013/2014

Support for societal purpose organisations through the VP/SII method continues to increase with over €5 billion invested since inception and average financial support per VPO increasing by 28% to €8 million from fiscal year 2012 to fiscal year 2013.

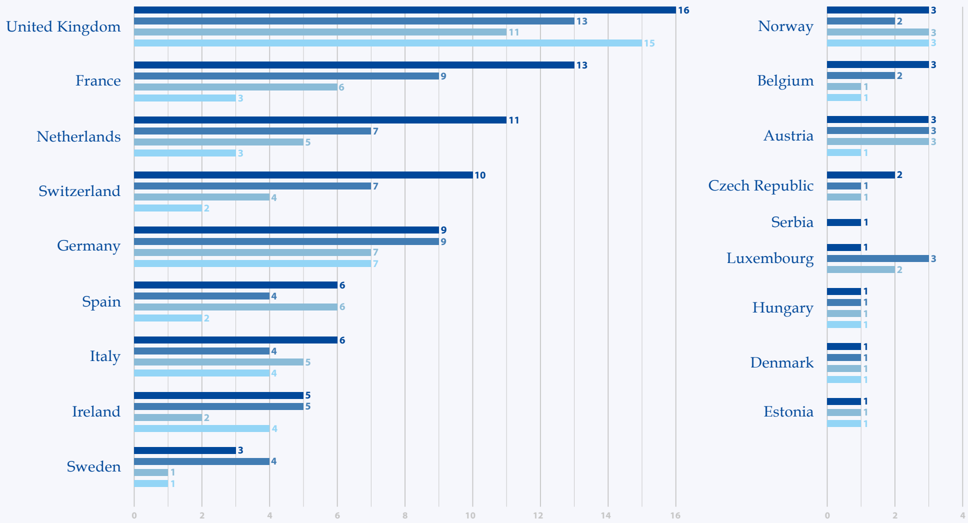

Figure 4:
Respondents by country

2014 n=95 **2013** n=75 **2012** n=61 **2011** n=50

Source: EVPA Industry Survey 2013/2014

In line with the previous year's survey, most of the respondents were based in Western Europe, the top 3 respondent countries being the United Kingdom (16%), France (13%) and The Netherlands (11%). Only four respondents are from Eastern Europe, with Serbia being represented for the first time.

Although there is no strong philanthropic tradition, in the Central and Eastern European countries VP is becoming more and more important in nurturing and financing the growth of the non-profit sector. In 2011, the Busan Partnership for Effective Development Cooperation specifically identified philanthropic organisations as potential significant partners in the development process[20]. These emerging economies have faced significant challenges in rebuilding a market economy and a social sector simultaneously, leading to widespread, unaddressed social needs. VP may have a particularly valuable role in helping to build stronger civil society institutions.

19. **Hehenberger, L., Boiardi, P.,** and **Gianoncelli, A.,** (2014), *"European Venture Philanthropy and Social Investment 2013/2014 – The EVPA Survey"*, EVPA.

20. **OECD netFWD,** (2014), *"Venture Philanthropy in Development: Dynamics, Challenges and Lessons in the Search for Greater Impact"*, OECD Development Centre.

Case Study: NESsT[21]

An example of this valiant effort is NESsT, one of the pioneers of venture philanthropy in Eastern Europe. NESsT was established in 1997 as an international non-profit organisation that develops sustainable social enterprises to solve critical social problems in emerging market economies. In fifteen years, it has trained more than 3,900 social enterprises and entrepreneurs, developed more than 120 social enterprises, invested more than $8 million, and wound down 24 of its investments. Because it operates in such challenging emerging markets, NESsT has developed quite differently from venture philanthropy organisations in more mature countries, such as the UK's Impetus. NESsT focuses on earlier stage organisations, often having to set up social enterprises to solve specific social problems rather than, as Impetus does, helping existing social enterprises scale up.

Its vibrant diversity and presence in so many different countries is perhaps the most outstanding trait of European venture philanthropy nowadays. The danger with such a multiplicity of approaches is that it could lead to fragmented initiatives with little collective impact. But the advantages of diversity outweigh the risks, as diversity is more likely to drive innovation.

Ever since the European Venture Philanthropy Association (EVPA) was set up in 2004, it has been the primary vehicle for encouraging the development of the VP model throughout Europe and has worked to bring together this 'broad church' of actors from diverse sectors with a common objective: to enable social purpose organisations to generate greater and more sustainable societal impact. EVPA's role as a network promoting and shaping venture philanthropy and social impact investment in Europe was recognised by a four-year Partnership Agreement signed with the European Commission in January 2014, under the financial Programme for Employment and Social Innovation (EaSI).

Currently, the association has over 214 members from 29 countries, mainly based in Europe, but also outside Europe, showing that the sector is rapidly evolving across borders. In 2011 a sister network of EVPA, the Asian Venture Philanthropy Network (AVPN), has been established replicating the EVPA model in the Asia Pacific region.

1.2.3 Motivation for Venture Philanthropy

Venture philanthropy organisations usually position themselves as complementary to other forms of funding available to SPOs. However, they do view the VP model as particularly appropriate for organisations undergoing rapid growth and development. VPOs recognise that many SPOs lack the internal capacity, particularly the appropriate business skills and growth capital, to grow significantly the scale of their social missions, reach new markets or be competitive when bidding for government contracts. The 'capital market' for social innovation is not as efficient or diverse as it is for developing fully commercial enterprises.

21. **Buckland L., Hehenberger L.,** and **Hay, M.,** (2013), *"The Growth of European Venture Philanthropy"*, Stanford Social Innovation Review.

INTRODUCTION

VP brings diversity in funding solutions and so helps to make the capital market more efficient, especially for rapidly growing and developing organisations.

Venture philanthropy is best described not as a blueprint, but rather as a movement that is evolving a set of practices. However, EVPA has decided to issue these guidelines in order to encourage the professionalisation and standardisation of the industry. The objective of the guidelines is to manage expectations as to the behaviour of VPOs.

VP is still an emerging player in the social sector, with the fundamental challenge of offering new solutions to the promotion and encouragement of entrepreneurship and innovation. In order to achieve this, the industry must address a number of 'enabling' issues, namely:

- Communicating and marketing what it does within the social sector (to multiple audiences, including SPOs, statutory agencies, other types of social sector funders)
- Developing a range of financial instruments and advisory services that meet the needs of SPOs
- Measuring the performance and social impact of SPOs (and ultimately the performance of the VPO)
- Collaborating with and learning from complementary capital providers such as foundations, private equity and venture capital firms, financial institutions, corporations and public funders – and to attract additional resources to the sector
- Building bridges with policy makers to create an enabling environment for VPOs and their investees.

1.3 Grant financing vs social impact investment – main approaches of VP

Venture philanthropy includes both grant funding and social impact investment. By grant funding we refer to the provision of non-repayable donations to the social purpose organisation: an Impact Only strategy. Social impact investment refers to funding that aims to generate a combination of financial and social return. To differentiate from more passive socially responsible investments, social impact investments must have a deliberate impact seeking strategy, aiming to generate measurable social impact. Although grants can in theory be provided across the spectrum of SPOs, they are generally most suitable for SPOs that do not have the potential to become financially sustainable, i.e. charities. In general, social impact investment is provided to SPOs in the categories of Revenue Generating Social Enterprises or Socially Driven Businesses, although loans can also be provided to charities with trading revenues. The division between the two approaches is not as clear-cut as it may appear in this schematic overview. There is a spectrum of increasingly sophisticated financing mechanisms included in social impact investment (see section 3.3).

INTRODUCTION

Throughout this document, we will highlight when the practices related to establishing a VPO diverge when using 'grant funding' as opposed to 'social impact investment' as a main approach. We have identified the following as areas of VP practice where approaches diverge:

- Considering the funding models that will be applied
- Types of financial instruments (section 3.3)
- Exit (section 3.6 and 4.6)

In all other sections of this document, we assume that VP practices are largely the same for both grant funding and social impact investment.

Key Issues and Learnings

- VP includes grant-making and social impact investment that seeks to complement other social sector funding sources by implementing:
  - A broader spectrum of eligible SPOs from non-profit service providers to profit-distributing socially driven businesses;
  - A high-engagement partnership approach that seeks to provide added value and capacity building support in addition to financial support;
  - A longer term investment time horizon than other sources of social capital.
- VP takes its cue from the private sector investment industry in terms of helping to create a more efficient capital market in the social sector. One of the ways in which this is done is by offering a range of financial instruments that can be used in different situations.
- Like its for-profit sector equivalents such as venture capital (VC), VP places an emphasis on impact measurement and management of investee SPOs as well as of the VPO's overall portfolio). VPOs focus on backing the whole organisation, rather than simply funding projects, much as venture capitalists do with their investees.

Part 2:

Key issues for the Venture Philanthropy Organisation (VPO)

This section addresses the following major VP-specific issues that a VPO should consider when setting up the VPO:

- VPO's funding model
- The VPO's organisational structure, including:
  - The founder(s)
  - The CEO and management team
  - The board
- The fundraising strategy
- The investment strategy

2.1 VPO's funding model

Before structuring the VPO, consideration should be given to the type of funding models that will be applied. The VP toolkit contains **tailored financing** as one of its key characteristics, and various types of instruments are available for funding, ranging from guarantees to grants (see section 3.3). The main question to be answered is whether the VPO will act as a social impact investor or focus on grant funding of target SPOs. In many European countries, tax and legal regulations distinguish between grant funding, and instruments that establish ownership titles. Grant funding can usually be done from organisations with a charitable status. However, other types of funding in various countries could conflict with a charitable status despite the fact that the primary goal for those instruments, when applied by the VPO, is social as well. The choice of instruments made will in many cases **impact the legal and tax structure** of the VPO, and it is recommended to seek specialist advice before incorporation.

In general, when the primary activity of the VPO is to provide grants to SPOs, 'grant financing', it tends to be set up as a foundation. If the VPO mainly invests in social enterprises, 'social impact investment' (using a spectrum of financing mechanisms, the primary goal being to generate social return), it is usually set up as a fund (or fund like).

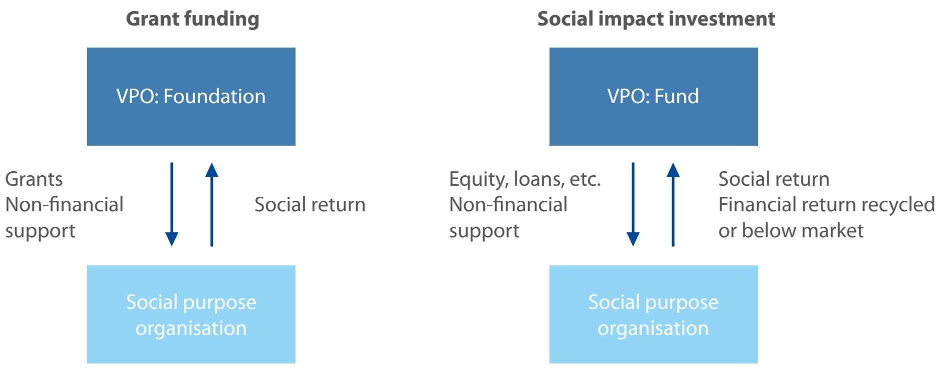

Figure 5:
Grant financing vs social impact investment

Source: EVPA

2.1 VPO'S FUNDING MODEL

Funds can be limited in time or evergreen, meaning that they do not have a limited life. Some VPOs have mixed structures that include both funds and foundations. Examples of mixed structures include Noaber Foundation in the Netherlands and BonVenture in Germany. In this document, we refer to both funds and foundations as VPOs.

VP/SII Industry by the numbers: from The EVPA Survey 2013/2014[22]

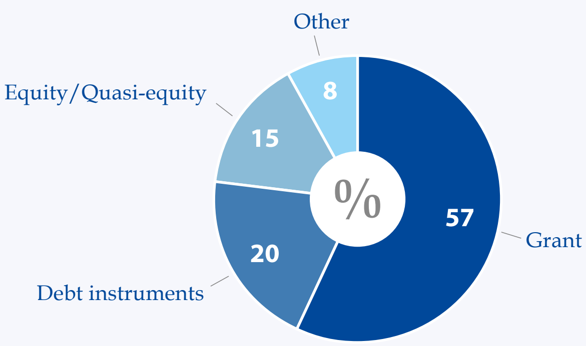

Figure 6:
% of 2013 VP/SII spend (€) by financial instrument

n=61

Source: EVPA Industry Survey 2013/2014

Grant funding is a key practice in European VP, with grants remaining the primary financing instrument in terms of € spend. However, recently, more VPOs are using financing instruments other than grants with an increase in the use of guarantees and hybrid grants.

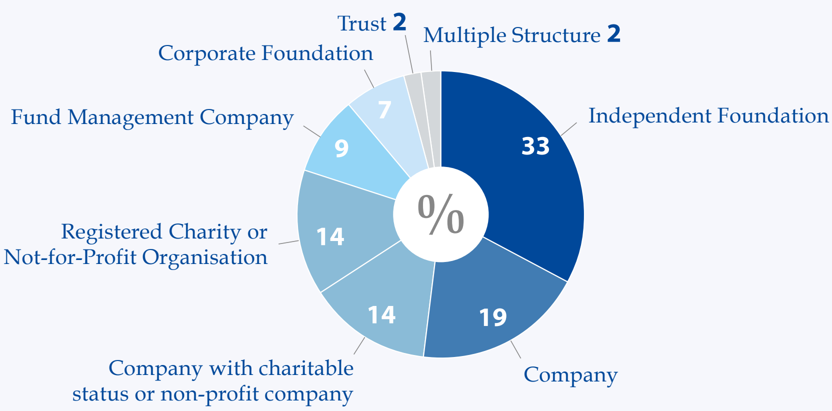

Figure 7:
% of 2013 VP/SII by organisation structure

n=95

Source: EVPA Industry Survey 2013/2014

In line with the results above regarding the prevalent funding models, the majority (70%) of the European VPOs are structured as non-profits such as foundations (either independent, 33% or linked to a corporation, 7%), charities (14%), companies with a charitable status (14%) or trusts (2%). For-profit forms are companies (19%), funds (9%) and multiple structures (2%).

22. **Hehenberger, L., Boiardi, P.,** and **Gianoncelli, A.**, (2014), *"European Venture Philanthropy and Social Investment 2013/2014 – The EVPA Survey"*, EVPA.

2.2 The VPO's organisational structure

The composition and capabilities of the VPO's founder, management team and board – and their mutual interaction – are all critical to the success of the VPO. This section discusses each in turn.

2.2.1 The founder(s)

Many of the pioneer VPOs are characterised by the presence of a founder, the organisation's main visionary and often a cornerstone investor. The founder often provides a significant financial contribution to the VPO and often needs to finance start-up costs that cannot easily be charged to the other investors. More recently, VPOs have emerged that were originated by established foundations, corporations, family offices, private banks and other larger institutions. In those cases, funding often comes from the institution backing the set-up of the VPO. However, whichever the origin, VPOs always need one or a few champions that promote the concept of VP within the funding institution and that lead the VPO during the start-up phase.

Founders typically come from one of the following backgrounds:

- 'Second career' start-up entrepreneur who can usually put in at least some capital, e.g. Noaber Foundation.
- Founder(s) from the private sector with a vision and some capital (such founders will tend to recruit a high-calibre CEO from the social sector as soon as possible), e.g. Oltre Venture Capital or Impetus Trust.
- 'Founder CEO' with vision, who recruits a young team to be trained in the skills required to execute the vision. These founders usually bring their skills and experience to the table rather than capital, and so fundraising is a critical need from the start – securing an early sponsor in these cases is ideal to build credibility quickly, e.g. CAF Venturesome.
- 'Co-founding', i.e. one person from the social sector (perhaps a social entrepreneur) and another from the private sector (e.g. investment, strategy consulting), e.g. One Foundation.
- Government-funded, independently managed VP-type funds, e.g. UnLtd's endowment comes from the Millenium Commission, and Inspiring Scotland.
- Founder within an established grant-making organisation, either setting up a new division or sponsoring a spin-out funding organisation, e.g. King Baudouin Foundation and Fondazione CRT.
- Several foundations set up by corporations, including the BMW Foundation and the Shell Foundation, have been moving into Venture Philanthropy.

2.2 THE VPO'S ORGANISATIONAL STRUCTURE

VP/SII Industry by the numbers: from The EVPA Survey 2011/2012[23]

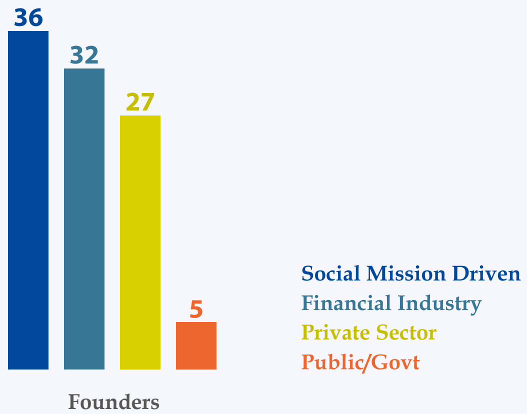

Figure 8:
Professional background of Founders and CEOs of VPOs

numbers in %
(Founders n=59, CEOs n=37)

Source: EVPA Industry Survey 2013/2014

According to the 2011/12 EVPA Industry Survey, the founders of VP/SII organisations mainly come from the social mission-driven sector (including foundations and other non-profit organisations, development organisations and social entrepreneurs). The financial sector (including private equity and venture capital, retail and investment banking, asset management and hedge funds) has moved to second place (32%). The private sector in general (including publicly traded companies, professional services and entrepreneurs) is also an important source of VPO founders (27%).

2.2.2 The CEO and management team

The CEO of a newly created VPO may be a founder or an individual recruited at an early stage by the founder(s). The CEO, the management team and the board must share between them a blend of skills and knowledge that can meet a very diverse set of demands.

The composition of the management team is obviously important, although it would be dangerous in a general discussion such as this one to be overly prescriptive. Professionalism is a necessary but not sufficient condition. Ideally, recruits should also 'share the vision' – i.e. be motivated by the social objectives of the VPO. Flexibility, an ability to work outside one's comfort zone, the possession of strong analytical skills and excellent people skills are all important attributes. They are often displayed by people who have worked across cultures and sectors or by individuals who have taken risky or unusual life or career decisions.

A successful management team will be able to wear two hats simultaneously during its work with SPOs. Its members should understand the specific social issues and needs that the SPO addresses and the latter's strategy for doing so. They should also maintain an 'investor perspective' that considers both the SPO's performance and its alignment with the VPO's objectives and with the rest of its portfolio.

23. **Hehenberger, L.**, and **Harling, A-M.**, (2013), "*European Venture Philanthropy and Social Investment 2012/2013 – The EVPA Survey*", EVPA.

2.2 THE VPO'S ORGANISATIONAL STRUCTURE

Different VPOs have taken different approaches to achieving the balance between the social sector 's perspective and the 'investor's' perspective, including:

- ☑ Hire both skill-sets into the management team, i.e. hire a very diverse team and work hard to ensure they learn from one another – build a learning culture
- ☑ Hire a team with backgrounds that complement those of the founder(s)
- ☑ Hire a team with investment backgrounds and challenge them to develop deep knowledge of the field at a rapid pace (you may need to develop ways of measuring whether they have succeeded).

How to hire to balance social and financial focus

Our collective wisdom tells us that a small team, typically one to four people, is the right number to start with. The profile could focus on people who are patient enough to understand how the social sector works, but who may not necessarily be from the social sector[24]. In general, there is a need for a mix between social and private sector backgrounds. Finding people who are open-minded and willing to learn new skills and new perspectives from others is essential.

The CEO must be able to sell the vision to the prospective management team. Having a compelling vision and being able to articulate it clearly and concisely are important, especially as VP is still an emerging phenomenon and is not well known as a career path. However, more recently, business students are showing an increasing interest in careers that integrate social and business such as social entrepreneurship, social impact investment and venture philanthropy.

It may be hard to attract the ideal candidate at the start. If it is necessary to compromise, calibre and energy are preferable to directly relevant experience. It may be necessary to upgrade a particular post when the hire has demonstrated success. To date, management teams have often been sourced through networks. Professional searches and advertising can play a part, although the novelty of VP can make the latter a difficult proposition.

Most successful VPOs in Europe have started with high-calibre teams that have significant experience – either held by the founders or gained through recruiting. According to practitioners interviewed in EVPA's report "Learning from failures in VP/SI"[25], team members must have basic financial skills – it is better to hire staff with a strong business or financial background (including business planning and financial skills) who can then learn about how to apply their skills to the social sector. The team overall needs to comprise a number of different experiences (from both the private and the non-profit sector) as each background brings something that contributes to the overall 'roundness' of the team.

24. We found that if the fund is focused around revenue-generating social enterprise investments, an investment perspective is critical, and this is typically not found among people from the social sector. However, people from social sector backgrounds are more critical among small teams investing in social-service or advocacy-type organisations, where earned revenue streams are not typically in place.

25. **Hehenberger, L.** and **Boiardi, P.**, (2014), *"Learning from failures in Venture Philanthropy and Social Investment"*, EVPA.

2.2 THE VPO'S ORGANISATIONAL STRUCTURE

A deep knowledge of the social sector becomes critical quickly but is not absolutely essential at the start-up stage. People with investment backgrounds must have the flexibility and – importantly – the humility to gain a deep understanding of the key issues for the VPO to function effectively and maintain credibility with social sector partners. Thus, the team's characteristics need to be aligned with the investee companies, so if the VPO has a large majority of social enterprises in its portfolio the background of the team shall reflect it. Finding board members or advisors from the social sector can enable this transition.

The solid understanding of the social market required includes:

- ☑ A clearly defined and comprehensive understanding of the social issues or needs that the VPO seeks to address and the actors operating in this sector that could be targets for learning or co-investment.
- ☑ An appreciation of the extent and type of funding supply from both the non-profit and the public sectors
- ☑ A clear grasp of the legal and regulatory environment

Elements proving a solid understanding of the social market

Working in this sector brings VPO staff often coming from a commercial background into close proximity with SPO staff with non-profit experience. The VPO will need to pay close attention to understanding the aspirations, perspectives and language of its SPO partners, and will need to invest time in communicating its own goals and analytical processes clearly. Openness, curiosity, patience, and humility are valuable traits on this path.

Remuneration is another key issue to resolve when setting up the management team. We have already identified the need for high-calibre staff and the relatively low level of awareness of VP as a career path. In an ideal world, therefore, a VPO should offer private sector remuneration packages to its team. However, financial constraints often mean this is not possible. Furthermore, it is well understood that the 'social return' that staff gets from working in the area of philanthropy does justify some level of discount from equivalent private sector remuneration. In practice, therefore, VPOs will often set their pay scales somewhere between equivalent scales in the social sector and private sector. It is common to provide non-financial incentives to offset this differential (e.g. extra leave, flexible working hours).

The social impact investment funds are often run with similar remuneration schemes as in venture capital and private equity, i.e. with the management team paid a management fee and an upside in the form of a carried interest. Considering the relatively small size of the

2.2 THE VPO'S ORGANISATIONAL STRUCTURE

social impact investment funds and the high-engagement approach, requiring substantial time investment in each investee, the financials are sometimes difficult to combine with salary levels in the private sector.

VP/SII Industry by the numbers: from The EVPA Survey 2013/2014[26]

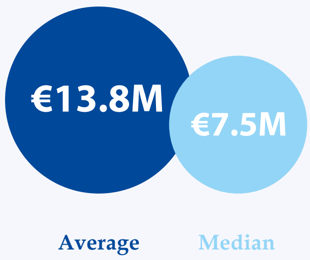

Figure 9: Average and median size of investment funds

n=24
representing 37 funds

Source: EVPA Industry Survey 2013/2014

The EVPA research into the size of these investment funds yielded an average size of €13.8 million for financial year (FY) 2013 (a 13% decrease compared to FY 2011) and median of €7.5 million in FY 2013 (a 15% increase compared to FY 2011), suggesting that although there are a few larger funds and the majority are much smaller, there is a tendency towards convergence in fund size.

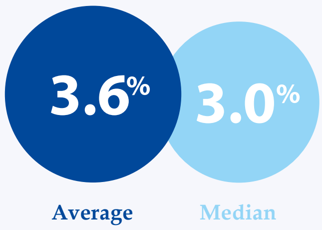

Figure 10: Average and median management fees (for those funds that charge fees)

n=22
representing 35 funds

Source: EVPA Industry Survey 2013/2014

Of the 22 European VPOs that provided evidence on their management fees in the EVPA Surveys, we see a wide range of fee levels. However, in general these management fees are not significantly higher than those seen in the venture capital or private equity world. The average management fee charged was 3.61%, while the median was 3.00%.

More recently, social impact investment fund managers are trying to raise larger funds, making it possible to pay appropriate salaries to the management (while making more investments). According to Erwin Stahl at BonVenture, bigger funds are more efficient because there are economies of scale linked to the management fee. As he explains: "For example, with a €4m fund, you need a 4% management fee to pay fixed costs of €200,000/year. With a €20m fund and a 2.5% management fee, you have a budget of €500,000/year which allows you to pay people a decent salary"[27].

26. **Hehenberger, L., Boiardi, P.,** and **Gianoncelli, A.**, (2014), *"European Venture Philanthropy and Social Investment 2013/2014 – The EVPA Survey"*, EVPA.
27. **Hehenberger, L.,** and **Boiardi, P.**, (2014), *"Learning from failures in Venture Philanthropy and Social Investment"*, EVPA.

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Another point of discussion is the carried interest, i.e. a share of the profits of an investment or investment fund that is paid to the investment manager in excess of the amount that the manager contributes to the partnership, in essence a performance fee rewarding the general partners for having increased the value of the investments[28]. In social impact investment, a current debate relates to the use (or not) of carried interest, and the need to link it to social impact achievement.

The introduction of carried interest in social impact investment has been promoted at European level through the Social Impact Accelerator (SIA), an initiative of the European Investment Fund[29]. SIA operates as a fund-of-funds, investing in social impact funds and requiring them to adopt such approach. The funds in SIA's portfolio distribute carried interest to the management team based on the social impact.

2.2.3 The board and governance structure

The role of the board should be determined early on – ideally by the founder(s) and any early board members. It should be noted that the board's role will evolve as the VPO moves from the start-up phase to a more 'steady state'. At start-up, the role and composition of the board will be heavily influenced by the needs of the organisation and the management team. In the longer term, boards will take on the kind of traditional governance and oversight roles seen in mature companies or organisations.

Some of the drivers for establishing the board's role, focus and composition during the start-up phase include:

- ☑ The need to grow the VPO's network (on both the fundraising and the investment sides)
- ☑ Public relations and building the VPO's profile
- ☑ Fundraising
- ☑ Providing skills, expertise and knowledge to the management team

Drivers for establishing the board's role focus and composition during the start-up phase

The level of engagement of the board is likely to be high – possibly even 'hands on' – during the start-up phase. Board members should be selected if they can provide the necessary time and if they are personally committed to the success of the organisation. Donor/investor representatives on the VPO board are likely to represent the VPO externally, including through fundraising activities and marketing, whereas board members that are hired to bring specific skills and experience to the table will be the ones that tend to engage with the management team of the SPOs directly.

28. https://en.wikipedia.org/wiki/Carried_interest
29. http://www.eif.org/what_we_do/equity/sia/

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During the start-up phase, when the VPO as a whole is in learning mode with respect to investment decision-making, the board is likely to act as the investment committee for final investment approval.

As an example, Social Innovation Fund Ireland, still at the beginning of its activity, does not have an investment committee and all the grant decisions are taken by the full board of six members.[30] Later, boards may feel that adequate decision-making processes have been established to allow the investment committee to take charge in the investment decision process.

The question of how to involve investors (or donors) in the decision-making process, calls for a separate analysis.

In practice, for European VPOs, there are three models of how to involve investors in investment decisions through the investment committee:

- *Management-driven model:* In some cases, the board adopts a pure VC model, with the fund management team (general partners) making the investment decisions independently from the board; this is the approach of Oltre Venture[31] and Bridges Ventures. Bridges Ventures has an investment committee for each investment team (Growth Funds, Social Sector Funds and Property Funds) made up of Partners and, in some cases, one or more external members. These convene for any investment decision, additional allocation of funds and regular portfolio reviews. Additionally, Bridges has a board (made up of Partners and Non-Executive members) and an advisory board made up of purely external members[32].
- *Mixed model:* In other cases, the VPO chooses to adopt a mixed model with investors being involved in the investment committee at different levels. For instance, the investment committee at the One Foundation was a subset of the advisory board[33] while two of the six members of the investment committee of SI2 fund are also its largest investors[34]. For BonVenture's third fund, there will be an independent investment committee consisting of three investors, one independent and two from the management team. The fund will be run using a partner model where management team members will have shares of the management company and have a say on the strategy[35].
- *Investor-driven model:* Yet another model is that of PhiTrust Partenaires where the investment committee is made up of investors in the fund that have expressed an interest in taking an active role in the investment. At PhiTrust, a separate supervisory board is composed of five people, including Olivier de Guerre (as President), and is composed of two individuals interested in the sector but who have no direct involvement with PhiTrust, and two who represent institutional investors in the fund[36].

30. **Deirdre Mortell, Social Innovation Fund Ireland**, email, October 2015.
31. **Luciano Balbo, Oltre Venture,** email, October 2015.
32. **Emilie Goodall, Bridges Ventures,** email, October 2015, and http://bridgesventures.com/our-team
33. **Deirdre Mortell, Social Innovation Fund Ireland**, email, October 2015.
34. **Pieter Oostlander**, **SI2 fund**, email, October 2015.
35. **Hehenberger, L.,** and **Boiardi, P.**, (2014), "*Learning from failures in Venture Philanthropy and Social Investment*", EVPA.
36. **Chloé Tuot, PhiTrust**, email, October 2015, and http://www.phitrustactiveinvestors.com/data//Rapport_annuel_2014_version_finale.pdf

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As the board is often involved in the decision process at VPOs, there is a need for a governance structure that includes a balanced mix of experiences from both the private and social sector. The EVPA publication *"Learning from failures in Venture Philanthropy and Social Investment"*[37] points out that, although diversity can bring challenges, having a rich mix of perspectives prevents VPOs from making mistakes. Members of the board must be chosen based on their collaborative mind-set, patience and capability to respect people with different backgrounds, but most of all for their entrepreneurial approach.

Experience also tells us that the board size should be kept small, typically three to five members. In cases where a VPO needs a larger board (e.g. if several board seats are requested by the VPO's investors), then it is recommended that the board's active engagement activities are assigned to a smaller sub-committee, which can meet frequently (e.g. monthly).

Inevitably, once the VPO is up and running, differences will emerge between the board and the executive management team over various aspects of the VPO's operations or investee SPOs, due to the deeper knowledge gained by the management team as they bed into their roles. The CEO, as the interface between the board and the management team, will play an important role in maintaining strong communications between the two groups and ensuring that their perspectives and expectations remain aligned. Fondazione CRT has offered each board member a management role on the investment vehicles of its philanthropic investment fund. PhiTrust also has the additional aspect that investment committee members take active roles, if they choose to, in the board of strategy committee of the investees in our portfolio, co-jointly with someone from the PhiTrust team.

2.3 Fundraising

The nature of the founder (see section 2.2.1) affects the type of fundraising necessary. Some individual founders and institutions have been able to fully fund the VPO without external fundraising, others engage in formal fundraising from third parties and some use a combination of both. When the VPO is closely linked to a larger institution, funding is often provided on a continuous basis by budgeting a certain amount to the VPO each year.

However, in many cases, the VPO needs to engage in fundraising in order to operate and have money to invest. The recent financial crisis has made fundraising a greater challenge than ever before.

37. **Hehenberger, L.,** and **Boiardi, P.,** (2014), "*Learning from failures in Venture Philanthropy and Social Investment*", EVPA.

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Raising capital successfully from third parties requires:

- ☑ A clear vision of what you intend to achieve with the capital
- ☑ A clear structure and investment strategy
- ☑ Credibility and ability to deliver the vision.

Requirements for successfully raising capital

VP has substantial potential, and has emerged from a movement to an industry. However, as an industry, VP still suffers from 'liability of newness'. Prospective donors and investors therefore need clarity on the VPO's investment model and goals. The founder(s) needs to articulate clearly how the money will be invested; which areas will be prioritised; what the overall social impacts will be; and how the VPO will manage to achieve its goals. The founders also need to consider how the VPO will sustain itself over time. Founders need to be able to articulate early on the options for driving to financial sustainability. The founder's personal track record will be critical.

In the social sector, the providers of capital are driven by a combination of heart and head. They will be motivated to support you by heart (the vision you create of the social good to be achieved) but also strongly influenced by the head – the plausibility of your plan and whether you are likely to achieve the agreed objectives.

This section will discuss both the sources and methodology for obtaining capital for a VPO at different stages of its development.

2.3.1 Start-up

Raising the initial capital is clearly difficult, since the idea of giving philanthropic capital to an intermediary (one of the cornerstones of venture philanthropy) is new to many. It helps if the founder or founders can commit some of their own resources, to cover both capital needs and the operating costs. This not only helps financially, but also demonstrates their commitment to the project.

The type of funds raised may influence the type of instruments that the VPO can ultimately offer (your investors will have their own preferences). This could mean that some potential investors may be more or less attractive targets, depending on the vision underlying the organisation. In the EVPA publication *"Learning from failures in Venture Philanthropy and Social Investment"*[38] Olivier de Guerre from PhiTrust Partenaires explains that "there are a number of private and institutional investors who are ready to embrace a social impact fund because they understand that there is higher risk and high uncertainty, but that the social return compensates for a lower financial return. Therefore, it is not necessary to adjust the investment strategy to raise additional share capital, but rather ensure that you

38. **Hehenberger, L.,** and **Boiardi, P.,** (2014), *"Learning from failures in Venture Philanthropy and Social Investment"*, EVPA.

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are targeting the right investors. If you are in a social impact investment fund, you know you have to look for a specific investor, not alter your investment strategy".

Potential sources of funding include:

Potential funding sources

- ☑ *The founders' network of contacts – friends, family and colleagues*. Boards of directors can be a valuable source of funding, both directly and through their individual networks. Some of this is a matter of luck, but the prior business experience of the founders and their track record of success are important drivers.

- ☑ *Trusts and foundations* generally make smaller grants to support projects, in comparison with VPOs. Promoting innovation can be an important motivation for these organisations, and they are thus most likely to support the first fund in a particular geographical area. Esmée Fairbairn Foundation in the UK has supported many of the pioneer UK VPOs such as CAF Venturesome and Inspiring Scotland.

- ☑ *Corporate sources (usually through their foundations)*. Often the language and thinking of corporates and corporate foundations tend to be well-aligned with VP. Corporate foundations such as the Shell Foundation operate like a VPO in their own right.

- ☑ *High-net-worth individuals* can sometimes be accessed through private banks. A VPO might attempt to build a long-term relationship with the bank's philanthropic advisors by introducing them to the concept of VP and bringing them to an EVPA event. Many EVPA members are private banks and their advisory services department. Offering clients the opportunity to invest in VP can be a value-added service that banks offer to their clients. BBVA in Spain invites its private banking clients to invest in the social enterprises that are selected through their Momentum Project.

- ☑ *Government agencies* will sometimes support efforts of this nature, in order to foster new ideas and to develop the social market. Be prepared, however, for a very long sales process and significant operating restrictions. In most cases, you will also need to bring in other investors to support the effort and to give your plan more credibility and independence. Recently, funds of funds that are government-supported have emerged both at European level, through the European Investment Fund's Social Impact Accelerator (EIF-SIA)[39], and at country level, through initiatives such as Big Society Capital[40] in the UK and the Portuguese Social Innovation Fund[41]. Such funds of funds are starting to invest in VPOs to build the societal impact ecosystem and will be potential sources of funding for VPOs in the future.

39. http://www.eif.org/what_we_do/equity/sia/
40. http://www.bigsocietycapital.com/
41. http://evpa.eu.com/blog/turning-it-on-its-head/

2.3 FUNDRAISING

Educating your potential supporters about both the methods and the benefits of VP investing is important. VPOs are relatively expensive to operate – in comparison with grant giving, for example – and the sector still needs to demonstrate how the investment activity results in increased social impact. A first step in that direction is for the VPO to clearly articulate its own **Theory of Change[42] as an investor**, i.e. the social change it aims to achieve through its investments and how it aims to do that (e.g. which sector(s) it will focus on, which type of support it will provide).

Potential supporters may be wary about investing in a blind pool – i.e. committing capital to a fund whose investment targets have not been identified. It may be necessary to pre-select five or six candidate organisations before commencing fundraising. Finally, you may need to demonstrate the VPO's capability by putting in place a start-up management team before raising funds. Clearly, this can present a chicken-and-egg situation. In reality, it probably means that, in the absence of a major early-stage sponsor, the organisation will necessarily grow slowly, starting with just a few people and expanding as it starts to build a track record.

In summary, the following are the key issues to consider before attempting to raise a first-time fund:

- ☑ Be clear about your objectives and try to articulate your own Theory of Change
- ☑ Carefully target your potential investors and develop an understanding of why they would want to support you – remember each potential supporter will have different motivations
- ☑ Anticipate the difficult questions and think through how you can respond credibly
- ☑ Find an early-stage lead sponsor – see if you can identify a foundation, financial institution, high-net-worth individual or other entity with a strong funding base. This will give you more capital and more credibility as you develop your operations
- ☑ Be prepared for a major effort – appreciate that the majority of the people you speak to will say no – learn from those rejections and adjust your approach as necessary
- ☑ Be optimistic and persistent

Issues to consider before attempting to raise a first-time fund

42. See Section 3 for more detail on the Theory of Change of the VPO and the investment strategy.

2.3 FUNDRAISING

VP/SII Industry by the numbers: from The EVPA Survey 2013/2014[43]

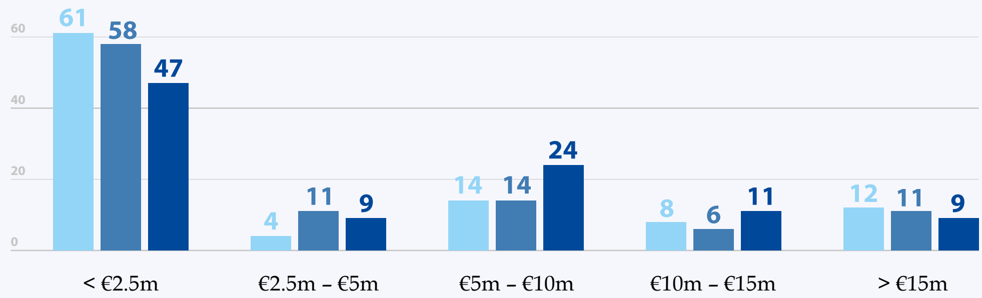

Figure 11:
Size of VP/SII budget FYs 2011–2013

2013 n=86
2012 n=71
2011 n=49

numbers in %

Source: EVPA Industry Survey 2013/2014

According to the 2013/14 EVPA Survey, budgets for VP/SII are increasing, but many European venture philanthropy organisations still have annual budgets lower than €2.5m.

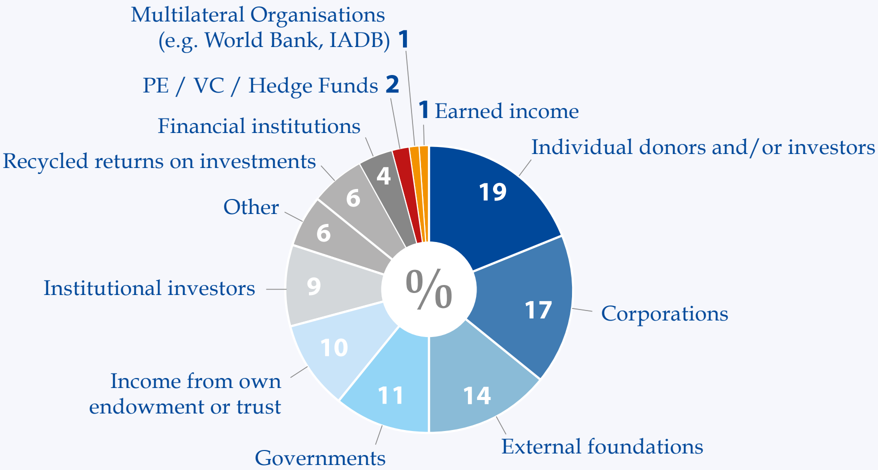

Figure 12:
Distribution of total funding made available to VPOs by source

n=85

Source: EVPA Industry Survey 2013/2014

Individuals, corporations and external foundations represented the main sources of VP/SII funding, with 19%, 17% and 14% of the total funding respectively. Governments remained stable as the fourth most important source with 11% of total funding. Interestingly, institutional investors became a key funding source, with 9% of the total (an increase of 7 percentage points from the previous year). Funding from own endowments, recycled returns and earned income represents 17% of funding, up from 10% in FY 2012, showing that VPOs are increasingly self-financing their activities. The importance of private equity / venture capital (PE/VC) and hedge funds as a funding source continues to decrease, from 7% in FY 2012 to 2% in FY 2014.

43. **Hehenberger, L., Boiardi, P.,** and **Gianoncelli, A.,** (2014), *"European Venture Philanthropy and Social Investment 2013/2014 – The EVPA Survey"*, EVPA.

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2.3.2 Follow-on funds

Follow-on funds ideally should not be raised until several years after start-up, so that you can point to the results achieved with the prior fund(s). In practice, however, you will probably have to fundraise constantly. The pioneer VPOs in Europe have been facing the challenge of raising their second funds. The advantage of raising the second fund is that there should be an established team, an established portfolio of investments (typically between four and seven) and some evidence to support the thesis that your intervention has made a positive impact. VPOs are increasingly data-driven and able to show the impact of their work through impact reports and financial accounts. Clearly, such work goes a long way in showing potential investors the level of professionalism of the VP approach and potential social (and financial) returns. Without these elements, a VPO is still essentially a start-up. Once these milestones have been achieved, the fundraising pitch can be based around the progress that has been attained and should facilitate the fundraising process. However, moving from the start-up to the follow-on phase can be difficult. Some supporters will be more animated by the excitement of a start-up and the opportunity of investing in a new concept. Moreover, the founders may have exhausted the appetite of their immediate network and have to start 'cold-calling'.

The profile of investors second or third time round is broadly similar to that of the funders that were targeted initially, but, depending on the strength of the investment case, they may offer a better reception. Institutional investors will be difficult to attract at start-up stage, but may make sense to bring in for a follow-on fund. However, as highlighted in EVPA's research on learning from failures[44], institutional investors tend to focus more on achieving high financial returns, sometimes to the detriment of social impact.

Other factors to consider:

- ☑ It may be worth adopting a sector-specific focus on areas that have delivered the most social impact, and becoming known as an expert in that specific sector.
- ☑ Use case studies from the portfolio where added value delivered and the social benefit achieved can be demonstrated clearly. Be careful that claims are not exaggerated and that they can be substantiated.
- ☑ Refine your investor targeting strategy. Within the general categories outlined above, there may be subgroups that are interested either in your target sector(s) or in the types of investments you make. Developing relationships with these key funders early and building trust and support should be a priority.

Issues to consider when raising follow-on funds

44. **Hehenberger, L.,** and **Boiardi, P.,** (2014), *"Learning from failures in Venture Philanthropy and Social Investment"*, EVPA.

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case study

Case Study: Oltre Venture[45]

Oltre Venture[46] is one of the first Impact Investment fund managers in Europe, founded by Luciano Balbo in 2006. Since its foundation, Oltre Venture has continuously and proactively supported Italian social enterprises and helped their strategic development. With the experience gathered from the first fund, Luciano Balbo decided to launch Oltre Venture II, which is one of the first funds to have received an investment committment fron EIF's Social Impact Accelerator. The table below provides a comparison of the two funds in their main features:

Fund Name	Vintage Year	Timeframe	Investors and Commitment	Legal form	Management Fee	Investment Target
OLTRE Fund I	2006	The fund has a duration of 10 years and an investment period no longer than 4 years.	€7.5 million raised from 22 investors, mainly from high-net-worth individuals (HNWI) and an important Bank Foundation.	Società in accomandita per azioni (SAPA) (Limited Liability Limited Partnership – LLLP)	Operational expenses covered by the founder	OLTRE I invested in 17 social enterprises belonging to the following sectors, microfinance, temporary social housing, healthcare and job placement. Three main investments (PerMicro spa, Ivrea24 and Società e Salute Srl) represent 66% of the total portfolio. OltreVenture chose to invest in companies characterised by highly innovative operating models, economic and financial sustainability and a special ability in offering high-quality services and/or products at low fees. However, their business models were not all fully sustainable and replicable.
OLTRE Fund II	2014	The fund will have a duration of 10 years, extendible to 13, and an investment period of 5 years.	Current commitment from private and institutional investors is about €26 million, of which €10 million invested by EIF	Currently in the process of authorisation by Bank of Italy	3%	OLTRE II investments will be mainly directed both to expansion companies with the necessity to grow further and to start-up companies. Only fully sustainable societal impact enterprises are financed. OLTRE II investments will focus on specific social sectors (education, healthcare, social housing, assistance, job placement); services provided to individuals, families, elderly and the young population; the most vulnerable areas of the country mainly through investments in agriculture and tourism; any other initiative that might promote social solutions creating a positive impact for the community.

45. **Vecchi, V., Casalini, F., Cusumano, N.,** and **Brusoni, M.**, (2015), *"Oltre venture: the first italian impact investment fund"*, SDA Bocconi School of Management.
46. http://www.oltreventure.com/en/

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Oltre Venture raised its follow-on fund about eight years after its start-up. The fund size has more than doubled mainly thanks to the commitment of institutional investors and of the EIF. The investors' profile is different from the ones targeted initially, who were mainly high-net-worth individuals (HNWI). HNWI and family offices have the advantage of higher flexibility when making investment decisions. But the investment they can provide is smaller, while demanding at the same time more involvement in investment decisions and management. The approach of institutional investors is different as they are able to invest larger amounts but require precise procedures to assess and to approve investments, which makes it extremely hard to access money from them.

Oltre Venture II, thanks to the bigger size, is able to finance social enterprises at early stage, when they mostly need capital to support a step-up in capabilities. This contributes to bridge the financing gap between the start-up and scaling phase, which affects most social businesses in their development. Oltre Venture I, on the other hand, made small seed-stage investments.

Among the Oltre Venture I portfolio, the three main investments (PerMicro spa, Ivrea24 and Società e Salute Srl) were considered success cases and became the proof of the team's ability to develop and manage new business models to attract further investment. In particular, Società e Salute is the fund's star investment, being a financially free-standing investment and a fully replicable business model. Its success story was used by Mr. Balbo as a reference case for the fundraising of Oltre Venture II, where the European Investment Fund (EIF) invested €10 million as anchor investor.

2.3.3 Other methods of raising capital

The funding model can pose challenges, especially when it comes to the financial sustainability of those VPOs that do not have an endowment and thus have to count on fundraising to find enough and sustainable funding. VP/SII needs 'patient capital' that is flexible enough to accommodate for unforeseen circumstances. VPOs have tried to find complementary revenue streams as a solution to the financial sustainability issues. Adding peripheral activities (such as consultancy), finding ways to recycle capital (through debt instruments and by reinvesting capital gains) and generating economies of scale in the management fees (by raising larger funds) are examples of methods to raise more resources.

For instance, to enable self-sustainability in terms of funding, NESsT has set up its own social enterprise that provides consulting services to organisations that need the tools that NESsT has developed. The profit goes back to NESsT and now constitutes 20% of the funding. It is building a business plan for an investment fund to enable funds to be recycled. It plans to use loans and equity – and diversifying its own income strategy. However, this new strategy will also be challenging given that NESsT's investees are mostly early-stage enterprises that often need patient capital requiring a longer period of repayment and lower interest rates[47].

47. **Hehenberger, L.,** and **Boiardi, P.,** (2014), *"Learning from failures in Venture Philanthropy and Social Investment"*, EVPA.

2.3 FUNDRAISING

Key Issues and Learnings

- **Role of the founder(s)** – The founder(s) of the VPO is the key visionary of the project and must communicate that vision to attract early interest from others. They must also start to map out the critical internal knowledge and expertise the VPO will need to focus effectively on specific social sectors or issues.
- **Role of the CEO, the management team and the board** – The CEO hire is the most critical move the VPO will make. The CEO must have a compelling vision, be energetic and have directly relevant experience. The make-up of the management team and board should reflect the needs of the VPO in terms of skills and knowledge. There is a delicate balance to strike between social sector experience and investment management skills. The board is likely to need to take on a more hands-on approach to supporting the management team in the start-up phase.
- **Fundraising** – Successful fundraising requires the ability on the part of the founder(s) to articulate a compelling vision for the VPO and to communicate to investors the potential level of social impact that VP can achieve. The founder's ability to provide some capital is often critical to success.

Part 3:

The Investment Strategy

3. THE INVESTMENT STRATEGY

VPOs are vehicles that channel funding from donors and investors to selected social purpose organisations (SPOs). A VPO's investment strategy will flow from a set of choices that determine its focus and its objectives. The most important choices for the VPO relate to its social and financial return goals.

First, the VPO needs to define its **social objectives**. Many VPOs have started to develop **their own 'Theory of Change'**[48] to articulate how and why it expects to achieve a change through its activities to solve a particular social problem.

In practice, defining its Theory of Change means that the VPO needs to determine:

- ☑ *The overarching social problem or issue that it aims to alleviate* – e.g. youth unemployment in Spain (including an assessment of the magnitude of the problem as the base case)
- ☑ *The specific objective it wants to achieve* – e.g. reduce youth unemployment in Spain by investing (financial and non-financial support) in social enterprises with innovative solutions to introduce youth in the labour force (including an assessment of what the greatest needs of such social enterprises are and how the VPO can help them)
- ☑ *The expected outcomes* – what the VPO must achieve to be considered successful (the milestones against which the VPO will be measured)

Key components of the Theory of Change of the VPO

EVPA's report "*A practical guide to measuring and managing impact*"[49] helps VPOs in the process of defining their social impact objectives, and embedding them in the overall impact measurement system. The impact measurement process outlined in five steps allows the VP/SII to better manage the impact generated through its investments. To manage impact, the VP/SII should continuously use the impact measurement process to identify and define corrective actions if the overall results deviate from expectations. This involves revising and readjusting the steps in the impact measurement process as lessons are learned, additional data is collected, or the feasibility of objectives set is questioned. It is important to see impact measurement as a learning process. A clearly articulated Theory of Change is necessary to be able to choose investments in SPOs that can contribute to solving the social issue that the VPO is addressing. The VPO needs to consider this question clearly before starting to make investments, and regularly revise and adapt as its investment strategy develops.

For the VPO, it is important to get the buy-in of key stakeholders (donors/investors, staff/human resources, SPOs) to the impact objectives of the VPO so that their expectations are managed and their contributions are aligned. Therefore, engagement with a VPO's key

48. http://www.theoryofchange.org
49. **Hehenberger, L., Harling, A.,** and **Scholten, P.**, (2015), "*A practical guide to measuring and managing impact - Second Edition*", EVPA.

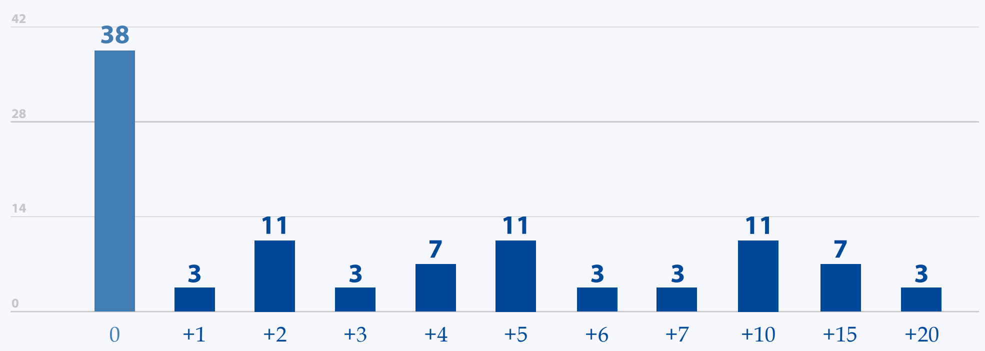
3. THE INVESTMENT STRATEGY

stakeholders should happen upfront by making sure they understand and support the impact objectives, and any major changes in these objectives should be properly communicated. It is useful to regularly engage with these key stakeholders to make sure that objectives continue being aligned, and otherwise implement corrective measures.

To better manage its social impact, a VPO needs to consider whether to define overall indicators to measure how well it has achieved its objectives as an organisation. Measurement of impact at the portfolio level is an important topic in impact measurement at the moment and there is no common practice as of yet.[50]

The VPO also needs to define its **financial objectives** (including if they are independent of or secondary to the social objectives). The targeted financial return will have an influence on the type of financial instruments used as well as on the types of organisations targeted. As an example, if the fund targets a 5% IRR net to investors, it means that it must achieve an average of 5% return across its portfolio, after paying the management fee and any other costs incurred. Since some investments may need to be written off as failures, the fund must generate superior returns from a number of investments to compensate for the write-offs. Pure grant-makers expect a -100% return on their 'investments'.

VP/SII Industry by the numbers: from The EVPA Survey 2013/2014[51]



When asked about the expected gross returns on the investment funds, VPOs reported they expect no positive financial return from 38% of their investment funds, i.e. they only expect capital repayment. 18 funds – 62% of the total – are expected to generate a positive return, between 1% and 20%.

Figure 13:
Expected gross return on investment funds

n=18
representing 29 funds

numbers in %

Source: EVPA Industry Survey 2013/2014

50. The EVPA report "*A practical guide to measuring and managing impact – Second Edition*" provides an overview of the main impact measurement methods currently in use among practitioners.
51. **Hehenberger, L., Boiardi, P.,** and **Gianoncelli, A.**, (2014), *"European Venture Philanthropy and Social Investment 2013/2014 – The EVPA Survey"*, EVPA.

3. THE INVESTMENT STRATEGY

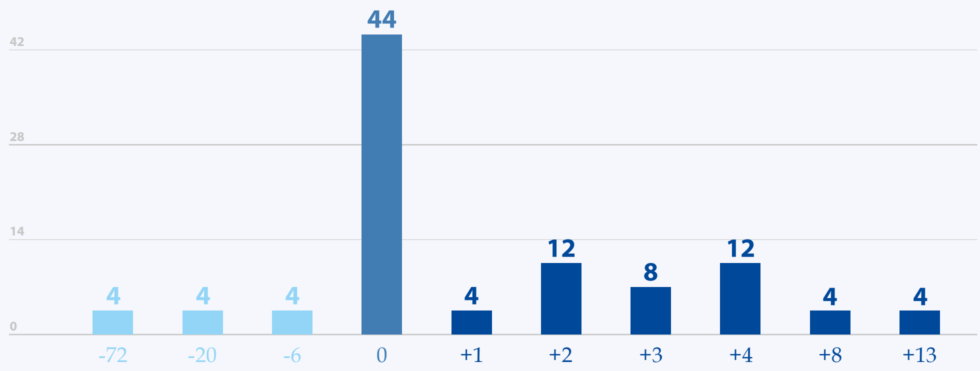


Figure 14:
Realised gross return on investment funds

n=16
representing 25 funds
numbers in %

Source: EVPA Industry Survey 2013/2014

The survey then asked the respondents about the realised gross annual return of the investment funds. Of the 25 funds represented by the 16 respondents to this question, 44% received full capital repayment and 12% made a loss, whereas 44% generated a positive return.

The Theory of Change and the financial return expectations are the cornerstones of the investment strategy, and will help the VPO further refine its investment strategy.

Broadly speaking, the investment strategy of the VPO is composed of five additional main elements:

Key components of the VPO's investment strategy

- ☑ 1. *Investment Focus* – which includes the geographical and social sector focus of the VPO's operations
- ☑ 2. *Type of SPO* – in which the VPO defines the size, type and stage of development of the investee(s) it supports
- ☑ 3. *The type of financial instruments* – will the VPO utilise funding instruments other than grants? The decision to apply investment instruments that establish an ownership title (like loans and equity type funding) will influence the structure of the VPO.
- ☑ 4. *The co-investment policy* – the VPO needs to make a decision as to whether it invests together with other actors, or alone, weighting the pros and cons of its decision.
- ☑ 5. *The non-financial support* – the VPO needs to decide how much non-financial support it provides, what type of NFS is core or non-core to its investment strategy and who provides each type of support. The non-financial support offered needs to be in line with the goals of the VPO in terms of financial return and societal impact, as defined in its Theory of Change.
- ☑ 6. *The exit strategy* – it is recommended that VPOs already think about how they will exit their investments as part of developing their investment strategy, allowing them to assess variables such as duration of the investment and potential exit routes.

3.1 INVESTMENT FOCUS

The overarching social and financial objectives of the VPO will determine its focus (1) in terms of sector and geography and the preferred models of intervention of the VPO involve the type of SPO that will be supported (2), in terms of type, size and stage of development of the SPO. The choice of the type of SPO to fund and the financial return expectation of the VPO will determine the financing instruments used (3). VP funding instruments are similar to the ones used by venture capital, with the addition of grant and grant-related funding. Often VPOs decide to co-invest with other funders in order to raise more funds for VP activities, promote VP activities among a wider audience and spread the risk (4). In addition to financial support, VPOs provide value-added services, such as strategic planning, marketing and communications, executive coaching, human resources advice, access to other networks and potential funders and support to develop the social impact goals of the SPO and to build an impact measurement and management system (5). Finally, the VPO considers how it plans to exit from its investments in general (6).

In the next sections we will focus on the most important elements of the investment strategy which constitute key issues for the Venture Philanthropy Organisation.

3.1 Investment focus

The investment focus determines the **sector** and the **geographical areas** the VPO wants to invest in.

In recent years, VPOs have shown signs of increased specialisation in terms of sector and geography, implying that each VPO is focusing more and more on a reduced number of sectors and geographies. This development comes from a growing recognition that VPOs can support their investees more efficiently by accumulating specific knowledge, and thus facilitating networking and knowledge sharing within their portfolios. More focus on a specific social sector and geography also adds value and enables the VPO to generate and demonstrate more impact.

3.1.1 Social sector choices

Many of the pioneer VPOs focused on demonstrating the VP model rather than on targeting a particular social sector. Having a broad-based portfolio allows a start-up VPO to appeal to a wide variety of stakeholders. VPOs operating in a small market where the social sector is still undeveloped may not be able to afford to focus on one sector as deal flow would be too limited. However, as the VP industry becomes more established, many VPOs have started to focus on one or several social sectors, recognising the importance of sector-specific knowledge to better assist their investees and to leverage the VPOs' resources. Such a focus makes sense because the VPOs can bring more added value in the areas where they develop a learning curve. Measuring impact is also facilitated by a clear investment focus on one particular social sector. EVPA Survey 2013–2014 provides an overview of the sectors that have received most attention by European VPOs (see the Box *"VP/SII Industry by the numbers"*, below).

3.1 INVESTMENT FOCUS

VP/SII Industry by the numbers: from The EVPA Survey 2013/2014[52]

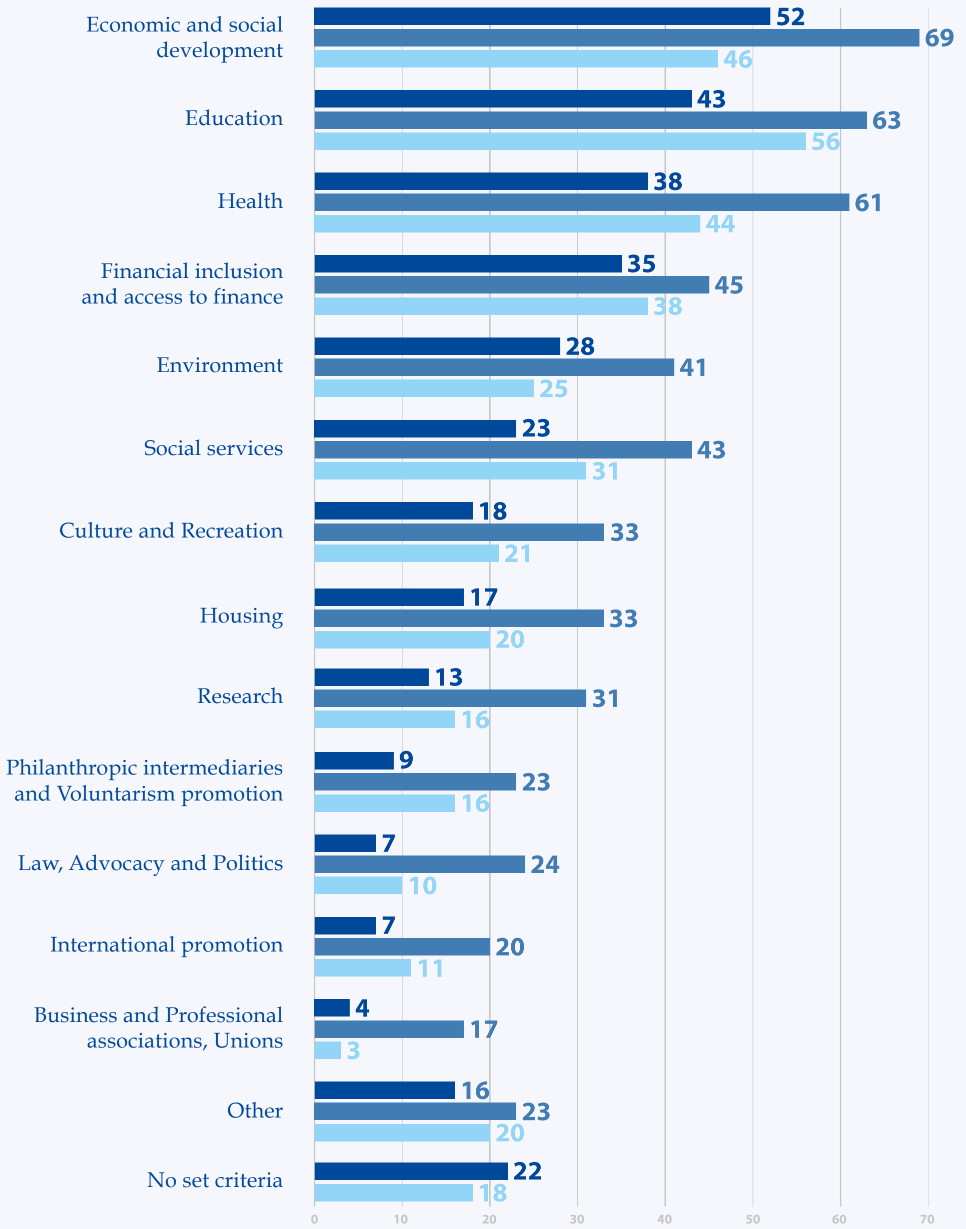


Figure 15:
% VP/SII spend by target sector: FYs 2011–2013

2013 n=90
2012 n=61
2011 n=49

multiple choice
numbers in %

Source: EVPA Industry Survey 2013/2014

In terms of funding in FY 2013, economic and social development topped the sectors (receiving 22% of funding), ahead of education (14%), research (13%), health (13%) and culture and recreation (9%). Altogether, the top 5 sectors made up for 71% of the total spend in FY 2013. Interestingly, the resources allocated to financial inclusion (5% of funding) and environment (8% of funding) sharply decreased from FY 2012 to FY 2013, whereas economic and social development and culture and recreation sharply increased (by 12 and 7 percentage points respectively).

52. **Hehenberger, L., Boiardi, P.,** and **Gianoncelli, A.**, (2014), *"European Venture Philanthropy and Social Investment 2013/2014 – The EVPA Survey"*, EVPA.

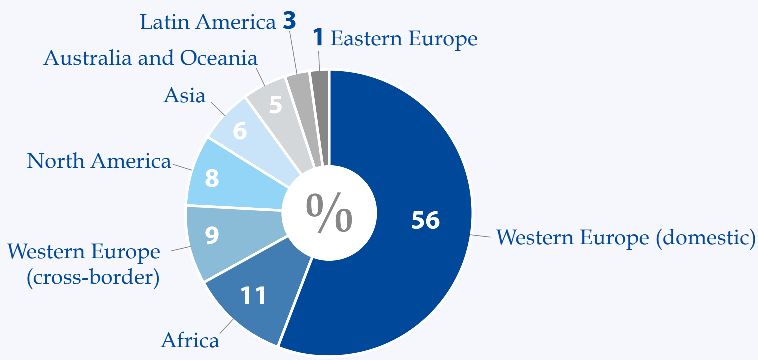
3.1 INVESTMENT FOCUS

3.1.2 Geographic choices

VPOs need to define the geographical scope of their activity. EVPA Survey 2013–2014 shows that most European VPOs operate in their own domestic market or invest in developing countries (see the Box *"VP/SII Industry by the numbers"*, below). VPOs that adopt an international focus face additional costs and management complexities in comparison with those operating within a single national jurisdiction. Engaged portfolio management is more complicated if the investee organisations are dispersed across several countries, while the development of an overseas network is necessary to maintain deal flow. Travel, legal advice and taxation advice will all impose additional costs.

Questions about the social impact investment market in the target geography need to be explored in this context as well. Is there a sizeable societal need that the VPO can address in a meaningful way? Is there sufficient deal flow to ensure that an appropriate level of investments will result? A market study is normally required to understand the relevant demographics and the quantity, quality and size of potential investment targets. To ensure that the VPO can invest selectively in high-quality organisations, the number of potential investments should significantly exceed the total number of investments required to fill the portfolio.

VP/SII Industry by the numbers: from The EVPA Survey 2013/2014[53]



More than half of the total spend by European VPOs is invested domestically (57%), while the amount invested outside the European borders is directed mostly to African countries (11%) and other European countries (9%), through cross-border funding – virtually non-existent a few years ago.

Figure 16:
Geographical focus of VP/SII organisations by € spend

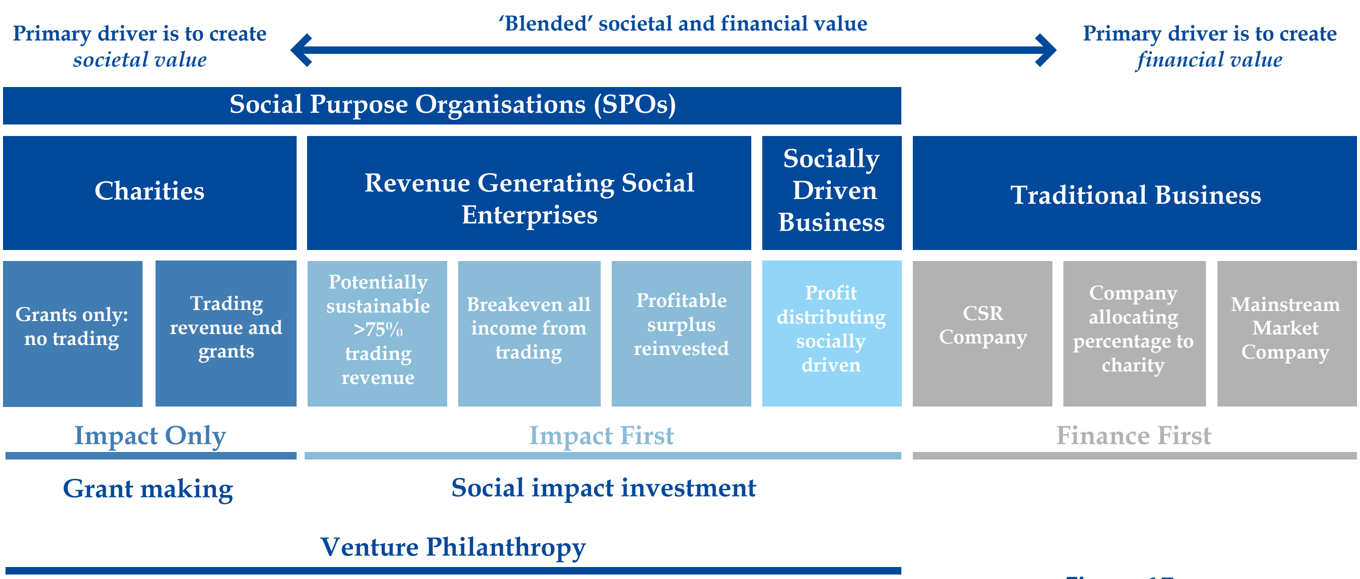
n=82

Source: EVPA Industry Survey 2013/2014

53. **Hehenberger, L., Boiardi, P.,** and **Gianoncelli, A.,** (2014), *"European Venture Philanthropy and Social Investment 2013/2014 – The EVPA Survey"*, EVPA.

3.2 Type of SPO

Venture philanthropy can operate across a spectrum of organisational types, from charities and non-profit organisations through to socially driven business. The diagram below sets out the range of organisational types that may have some social mission of one form or another. Those that are typically considered for investment by VPOs will generally fall into the Charities, Revenue Generating Social Enterprise and Socially Driven Business categories, collectively referred to as Social Purpose Organisations (SPOs) in this paper:



EVPA
EUROPEAN VENTURE PHILANTHROPY ASSOCIATION

Figure 17:
The Investment Spectrum

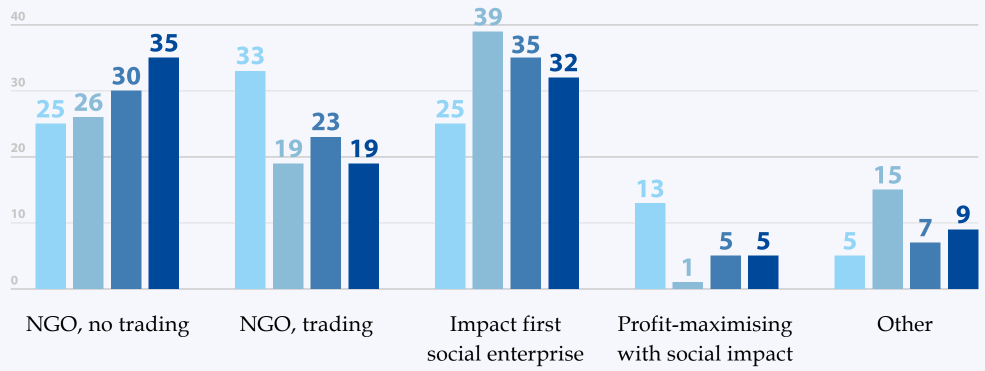
Source: EVPA[54]

Venture philanthropy is not appropriate for all SPOs, just as venture capital is not the best form of financing for commercial businesses at all stages of their lifecycle. In general, VP is best suited to SPOs that require an injection of capital to achieve a 'step change' in their operations (see the Box *"VP/SII Industry by the numbers"*, below). For some, this may mean providing finance that enables the SPO to replicate their operating model in a new or much more broadly defined target market. For other more established SPOs, VP funding may be appropriate in instances where the organisation is underperforming and seeking to re-design its core strategy or restructure operations.

54. Adapted from John Kingston, CAF Venturesome, by Pieter Oostlander, Shaerpa.

3.2 TYPE OF SPO

VP/SII Industry by the numbers: from The EVPA Survey 2013/2014[55]



Non-profits without trading revenues and social enterprises are the key targets of the VP/SII investment, receiving 35% and 32% of total spend respectively.

Figure 18:
VP/SII spend (€) by type of investee FYs 2011–2013

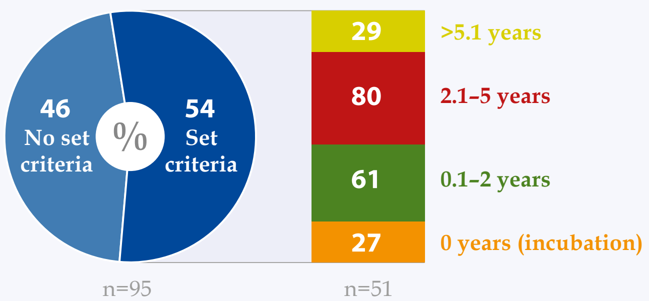
2013 n=82
2012 n=64
2011 n=51
2010 n=44

numbers in %

Source: EVPA Industry Survey 2013/2014

Venture philanthropists generally want to direct their resources to young, small to medium-sized sized organisations with growth potential or to organisations that are at an inflection point such as scale up, merger or turnaround (see the Box *"VP/SII Industry by the numbers"*, below).

VP/SII Industry by the numbers: from The EVPA Survey 2013/2014[56]



The most common age of investee organisations is 2–5 years (80%). Some VPOs also target early-stage organisations with an age of 0–2 years (61%), others take the risk of incubating start-ups (27%), and about 29% of VPOs invest in more mature organisations that are more than 5 years old.

Figure 19:
In which phase do VPOs seek investees at the time of investment?

multiple choice
numbers in %

Source: EVPA Industry Survey 2013/2014

It is important to invest in organisations in the early stage of development but VPOs investing in early-stage SPOs may face difficulties in attracting capital: the ecosystem is slow in recognising the importance of early stage. The early stage of development calls for more patient capital and this could reduce the funding possibilities.

55. **Hehenberger, L., Boiardi, P.,** and **Gianoncelli, A.**, (2014), *"European Venture Philanthropy and Social Investment 2013/2014 – The EVPA Survey"*, EVPA.
56. idem.

3.3 TYPES OF FINANCIAL INSTRUMENTS

In terms of size, most VPOs invest in organisations that are small to medium.

However, there is still divergence in what works best with regard to the VPO size. Some VP CEOs propose that VPOs should not invest in small SPOs, but rather focus on a few, large investees that can achieve disrupting impact. As the risk is high, VPOs need to invest in organisations that have potential to scale, and in entrepreneurs that are willing to do so[57].

3.3 Types of financial instruments

VP funding instruments are broadly similar to those used in the commercial investment sphere, but also include the grant and grant-related funding instruments.

1. **Guarantee:** the SPO can be supported with bank loans guaranteed by the VPO. The VPO in this case does not need to supply cash upfront, but it opens up access to regular funding sources by taking on some or all of the risk that the lender would otherwise incur.

2. **Debt:** a VPO can also provide a loan to the SPO, charging interest at or below market rates. The loan may carry a risk that exceeds what is usually acceptable for a commercial lender, or the normal commercial terms may be too onerous for the SPO. The interest charged varies also in relation to the securitisation and repayment priority of the loan (senior vs subordinated loan). A variation to this instrument is a loan with a social performance-related interest rate. When certain defined social targets are met, a discount on the interest rate will apply. Or, if variable, the higher the social return, the lower the interest rate would be.

3. **Mezzanine finance (also known as quasi-equity):** this involves the provision of a high-risk loan, repayment of which depends on the financial success of the SPO. This instrument bridges the gap between debt and equity/grant through some form of revenue participation. Examples include a loan that is only repayable through royalties based on the future sales of a product or service; or a royalty-sharing agreement that can be activated once an agreed profitability threshold has been reached. These instruments can offer an appropriate balance of risk and return.

4. **Equity**: a VPO may opt to acquire part of an SPO's business. This can be appropriate when the prospect of a loan repayment is low or non-existent. It holds the possibility of a financial return in the form of dividend payments. In addition, it allows for the possibility of a transfer of ownership to other funders in the future.

Types of financial instruments

57. **Hehenberger, L.,** and **Boiardi, P.,** (2014), *"Learning from failures in Venture Philanthropy and Social Investment"*, EVPA.

3.3 TYPES OF FINANCIAL INSTRUMENTS

☑ 5. **Grant**: Funding in the form of a cash allocation that does not establish rights to repayments or any other financial returns. There are innovative forms and uses of grants that may incentivise the success of the exit plan. Challenge grants can be used to incentivise the success of the exit plan. Atlantic Philanthropies includes requirements for matching support in its concluding grants, to help its investees replace Atlantic's funding where possible, and to adjust gradually to lower levels of support when a full replacement is not available[58].

☑ 6. **Hybrid instruments**[59] include elements of grants, equity and debt capital. The grant character can be explained through the fact that there are no interest costs and, in certain pre-agreed scenarios, the financing instrument is converted into a grant. Financing instruments with hybrid capital character include:

- *Recoverable grants:* loans that must be paid back only if the project reaches certain previously defined milestones. If the milestones are not reached, the recoverable grant is converted into a grant. This mechanism can be used if success of the project enables the social enterprise to repay the loan to the social impact investor.
- *Forgivable loans:* loans which are converted into a grant in the case of success. If the social enterprise reaches the goals agreed on beforehand by the investor and investee, the loan does not have to be repaid.
- *Matching conditional deferred loan:* the second tranche of the loan is paid only if a certain number of predefined KPIs and milestones are reached.
- *Convertible grants:* the social impact investor provides the enterprise with a grant that is converted into equity in the case of success.
- *Convertible loans:* unsecured loan or subordinated loans, with the option (either to the debtor or the lender) to convert into equity stake. This option to convert may be exercised by the VPO when financial return perspectives unexpectedly rise, thus offering the opportunity to generate additional return on the investment by owning an equity stake with upward potential rather than a loan with limited financial gains. Alternatively, this instrument can be used in situations where the prospect of loan repayment may drop below earlier expectations, hence offering the SPO a possibility to get rid of a liability and convert it into a form of funding that cannot be reclaimed.
- *Revenue share agreements:* the investor finances a project and receives a share of future revenues. This risk-sharing model can be used for the repayment of the financing and gives the social enterprise financial flexibility.

58. **Proscio, T.,** (2014). *"Harvest Time for The Atlantic Philanthropies. 2012–2013: Decline and Rise"*. Center for Strategic Philanthropy and Civil Society. Stanford School of Public Policy. Duke University.
59. **Achleitner, A., Schönig, M., Heinecke, A., Noble, A.,** and **Spiess-Knafl, W.,** (2011), *"Social impact investment Manual An Introduction for Social Entrepreneurs"*, Technische Universität München and Schwab Foundation for Social Entrepreneurship.

3.3 TYPES OF FINANCIAL INSTRUMENTS

The table below provides a comparison of the financing instruments described above from the SPO's point of view[60]:

Financial Instrument	Duration	Periodical Payment	Final Repayment	Implications for Social Enterprise
Guarantee	Long term (3–7 year)	Interests (bank)	Yes (bank)	- No dilution of ownership - Risk sharing with the social impact investors - High entrepreneurial flexibility in the use of capital
Debt	Long term (3–7 year)	Interests	Yes	- Annual interest payments require low-risk business model - No dilution of ownership - Far-reaching rights of capital providers in case of default - High entrepreneurial flexibility in the use of capital
Mezzanine (or Quasi-Equity)	Long term (3–7 year)	Interests	Yes	- Annual interest payments require predictable cash flows - Dilution of ownership only if converted into equity - Mandatory repayment - Profit participation for social impact investor
Equity	Unlimited	Dividend	No	- Dilution of ownership - Social impact investor receives control and voting rights - Profit participation for social impact investor - Potential impact on corporate culture
Grant	Short term	No	No	- Usually restricted use for pre defined projects - High fundraising costs - Low entrepreneurial flexibility
Hybrid Instrument	Long term (3–7 year)	No	Depends upon structure	- Inexpensive financing instrument - No dilution of ownership - Risk sharing with the social impact investor - Great structuring flexibility

The above list refers to the most commonly used funding instruments in the VP sector, but it is not exhaustive. Different variations and combinations of instruments are possible. The range of options available, therefore, should be seen as a continuum rather than a set of discrete choices. The choice of instrument or the combination of instruments applied depends on the organisational structure of the SPO, its specific opportunities and needs, as well as the return expectations and investment strategy of the VPO, often conditioned by the donors' wishes.

60. idem.

3.3 TYPES OF FINANCIAL INSTRUMENTS

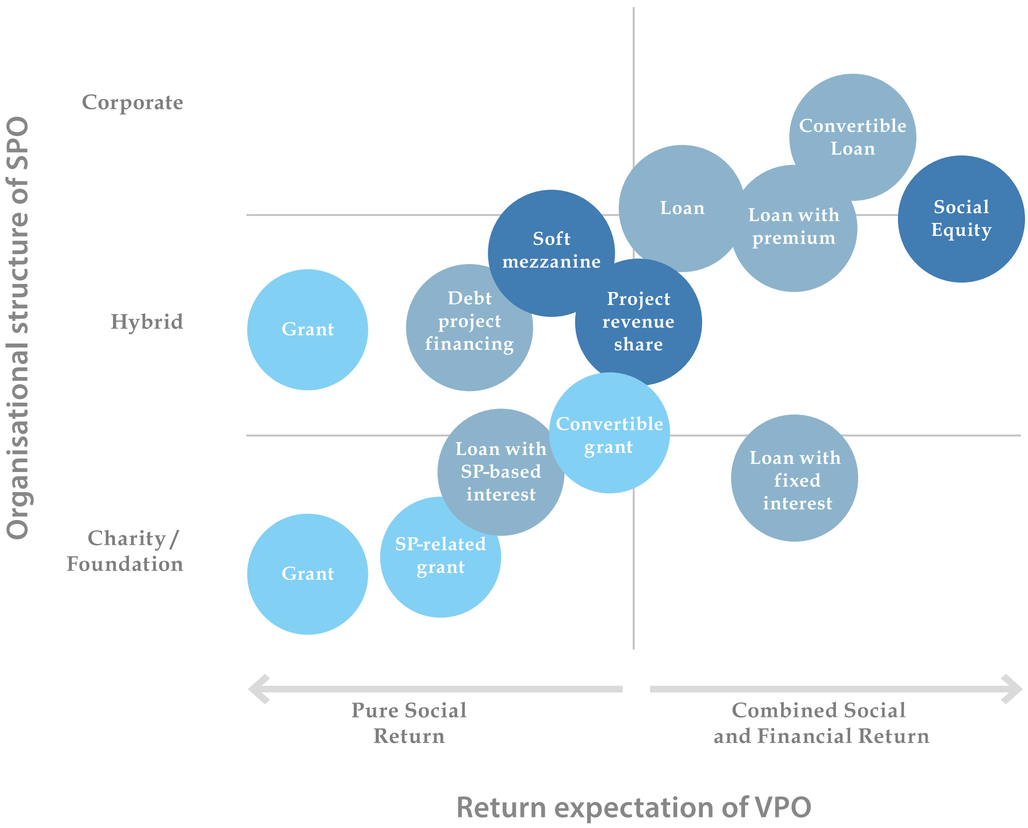


Figure 20:
Financing instruments: SPO organisational structure and VPO return expectation

Source: EVPA

The diagram above pictures the organisational structure of the SPO on one axis and the return expectations of the VPO on the other axis. In the left-hand bottom corner, if the SPO is a purely charitable organisation with no possibilities of generating income and lacking securitable assets, the funder should only use grants or grant-related instruments, without expecting any financial returns. In the right-hand top corner, the funder invests in the equity of a hybrid or corporate, expecting a social as well as a financial return.

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

3.3 TYPES OF FINANCIAL INSTRUMENTS

Using tailor-made financing, assessing the needs of the SPO before offering the most suitable funding mechanism, has several potential advantages:

Advantages of using tailor-made financing

- ☑ It can achieve greater impact by finding the most appropriate solution for each individual case
- ☑ The range of financing mechanisms offered may encourage an SPO to take a more active role in assuring its own financial sustainability
- ☑ It can help to broaden the SPO's vision to include a wider range of social impact investors
- ☑ It can improve the VPO's asset management (i.e. funds can be recycled when not only grants are used)

VP/SII Industry by the numbers: from The EVPA Survey 2013/2014[61]

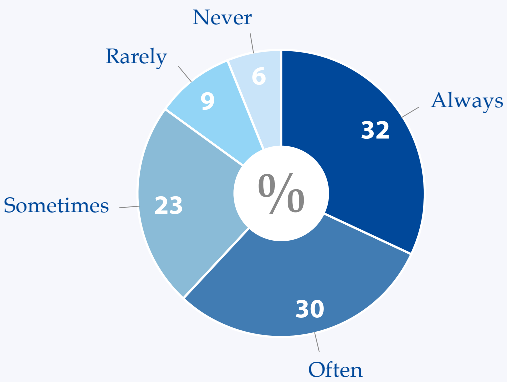


Figure 21: Organisations adapting their financing model to the needs of their investees

n=95

Source: EVPA Industry Survey 2013/2014

The statistics from the Survey also show that tailored financing is a reality in Europe: the majority of European VPOs (62%) do adapt their financing model to meet the needs of their investees either always (in 32% of the cases) or often (in 30% of the cases). Only a smaller share of VPOs (23%) adapts the financing model in some cases or rarely (9%) and only 6% reported not being able to adapt the financing model to the needs of the investees.

Some SPOs may be hesitant to work with funding mechanisms other than grants because they perceive them as risky or simply confusing. Grants can be used in situations that overlap with other types of financing. These situations can be locally specific (to the funding market in a particular country for example) as well as specific to the solution provided by

61. **Hehenberger, L., Boiardi, P.,** and **Gianoncelli, A.,** (2014), *"European Venture Philanthropy and Social Investment 2013/2014 – The EVPA Survey"*, EVPA.

the investment and to the length of time needed to solve the problem. Grants are particularly well suited to situations where the possibility of generating earned income is highly unlikely, undesirable or difficult to achieve within the investment horizon of the VPO. Large-scale systemic change processes that attempt to alter an entire sector may require ten years or more before generating revenue and would therefore require grant funding rather than other types of funding instruments. Furthermore, grants or grant-related instruments will be preferable when earned income of the recipient organisation is anticipated to be insufficient to cover expense budgets, and in the absence of securitable assets. However, in the EVPA report *"Learning from failures in VP/SI"*[62], experienced VPOs expressed some frustrations in the use of grant instruments. Issues arise because it is sometimes difficult to control what grant money is used for and in some cases the lack of high-quality projects that can be financed through grants. Suggestions on how to overcome these challenges include disbursing the grant according to milestones and requesting a matching grant. However, grants are essential to act as risk capital in particular to fund high-risk organisations.

In the same report, debt is recommended as a good funding solution when starting to experiment with VP. In particular, convertible loans can be used instead of equity to avoid costly valuations. However, one should bear in mind that non-grant instruments have limitations, as they imply some level of income generation. Repaying a loan from third-party grants or donations may not be acceptable. Moreover, they can also give rise to conflicts between social and financial objectives.

3.4 Co-investing policy

Co-investment can be an important part of a VPO's investment strategy. It represents an excellent way of raising funds for VP activities – and may be easier than raising funds for the VPO itself. In addition, it can help to promote VP among a wider audience. It also eliminates the 'blind pool' element, whereby investors are asked to fund unidentified organisations. It can help VPOs to target suitable trusts and foundations that are appropriate for a given investment. Co-investing does prompt certain cost considerations. Some VPOs may wish to charge co-investors a fee for managing the investment – to share overheads. This can often be a difficult negotiation. Co-investing can also be risky in particular if the co-investors do not have similar objectives. There are several accounts in the sector of difficulties arising during the investment period when purely financial co-investors opted out of an investment that was doing well from a social impact perspective, but without generating the desired financial return – forcing the investee out of business and the social impact investor to fail[63].

For these reasons, as reported in EVPA's research on exit strategies[64], a recommendation before engaging with co-investors is for the VPO to assess the co-investors' investment strategy and objectives, financial/impact trade-offs and exit plans, to make sure they are compatible and aligned. Furthermore, as with the SPOs, it is important to agree on roles and responsibilities among co-investors up front. Although co-investors who add value

62. **Hehenberger, L.,** and **Boiardi, P.,** (2014), *"Learning from failures in Venture Philanthropy and Social Investment"*, EVPA.
63. idem.
64. **Boiardi, P.,** and **Hehenberger, L.,** (2014), *"A practical guide to planning and executing an impactful exit"*, EVPA.

3.4 CO-INVESTING POLICY

are a definite plus, managing the consortium is easier if there is one active lead investor – usually the VPO – and a syndicate of other investors that are mainly passive.

Other aspects of the relationship should also be agreed upon:

- ☑ How often will co-investors attend regular review meetings?
- ☑ Will they help to supply or source value-added services?
- ☑ Will they automatically follow the lead investor in continuing or stopping funding in a crisis?
- ☑ What are the reporting obligations of the SPO and the lead investor?

Aspects of the co-investment relationship to agree upon beforehand

Co-investment	
Pros	**Cons**
• More funds available for target organisations; VPO may invest in more organisations • Spreading risk - Additional validation of investment opportunity - Shared risk in case of failure and should additional funding be required • Target organisation is not dependent on one funding source • Mitigate possible lack of deal flow • Co-investors can add specific skills, for example, many foundations have deep knowledge of specific social sectors • Reduce demands (reporting, etc.) on the SPO if lead investor manages relationship • May increase the reputation of the SPO through multiple investment partners	• Additional liability for VPO management organisation if co-funders lean on the work of VPO • Fund management cost ratios may increase since the same support organisation (VP management team) is managing a significantly larger portfolio – if co-investors do not contribute to management costs • Potentially more time-consuming for VPO and investee in terms of reporting and relationship management issues • Potentially slower decision-making • VPO may have to sacrifice independence • Misalignment in the investment strategy of the co-investors can generate issues throughout the investment period and at the time of exit • Co-investors without a local presence in the geographies where they invest may 'free ride' without adding value.

3.4 CO-INVESTING POLICY

VP/SII Industry by the numbers: from The EVPA Survey 2013/2014[65]

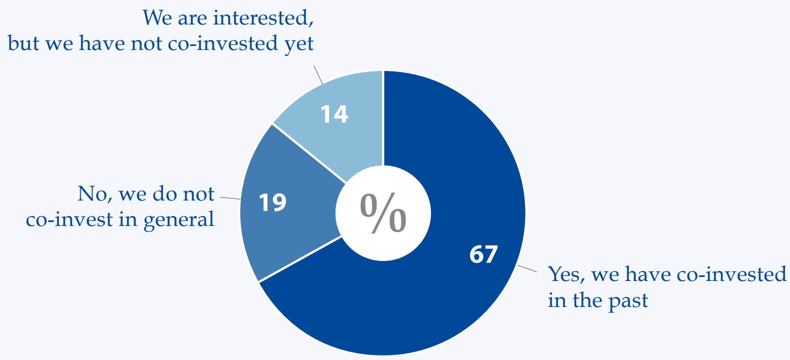


Figure 22:
Co-investment

n=94

Source: EVPA Industry Survey 2013/2014

Co-investment is a key component of European VPOs' investment strategy. About 67% of respondents to the EVPA Survey have co-invested in the past and 14% say they are interested to do so, even if they have no done so yet. Only one fifth of the respondents reported not to be used to invest with others.

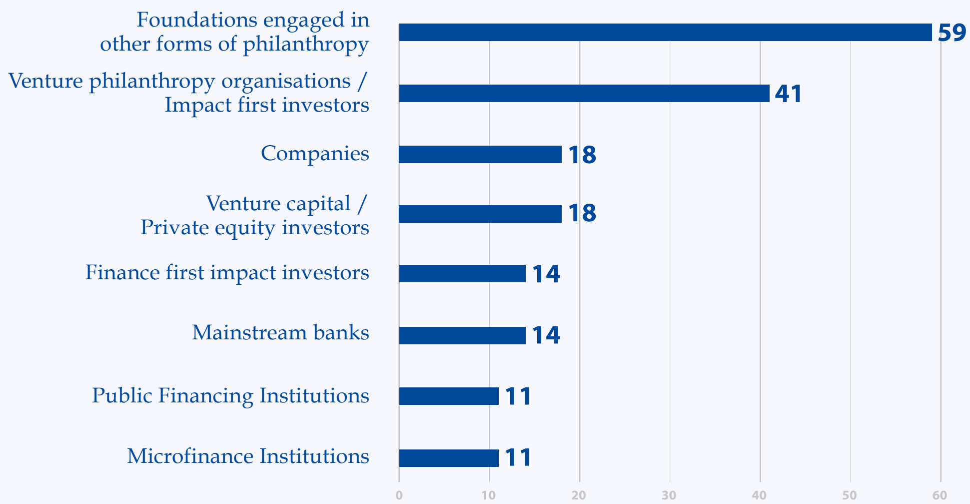


Figure 23:
Type of co-investors

n=44
multiple choice
numbers in %

Source: EVPA Industry Survey 2013/2014

Almost two-thirds of VPOs that have co-invested have done so with foundations (59%), while 41% have co-invested with other VPOs. Companies and VC/PE followed with 18% of the respondents reporting having co-invested with each of the two categories, followed by finance first impact investors (14%) and mainstream banks (14%). These results are consistent with the view that VPOs tend to co-invest with others that have a social impact focus.

65. **Hehenberger, L., Boiardi, P.,** and **Gianoncelli, A.**, (2014), *"European Venture Philanthropy and Social Investment 2013/2014 – The EVPA Survey"*, EVPA.

3.5 Non-financial support[66]

The non-financial element of a VPO's support can be as important to the investee's development as the finance the VPO provides. EVPA defines non-financial support as the support services VPOs offer to investees (SPOs) to increase their societal impact, organisational resilience and financial sustainability, i.e. the three core areas of development of the SPO.

Social impact	The social change on the target population resulting from an SPO's actions.
Financial sustainability	The assessment that an SPO will have sufficient resources to continue pursuing its social mission, whether they come from other funders or from own revenue-generating activities.
Organisational resilience	The assessment of the degree of maturity of an SPO, in terms of the degree of development of the management team and organisation (governance, fund-raising capacity etc.).

Figure 24:
The three areas of development of the SPO

Source: EVPA

As **impact measurement and management** are central to the VP approach, the VPO will put particular effort in supporting the SPO's strengthening its societal impact. The goal of impact measurement is to manage and control the process of creating social impact in order to maximise or optimise it (relative to costs).

In its report "*A practical guide to measuring and managing impact*"[67] EVPA has devised a five-step framework to guide VPOs in developing an impact measurement process for the SPO. We recommend a detailed reading of that report to fully understand how to implement impact measurement. EVPA is playing a leadership role in the impact measurement field, as shown by the extent to which EVPA's work on impact measurement is being referenced in the European Commission's Standard[68] on impact measurement, and our participation in and contribution to the report[69] produced by the Working Group on Impact Measurement of the taskforce on social impact investment established by the G8. In fact, by using the EVPA guidelines, VPOs can feel confident that they are adhering to the EU standard on impact measurement. In this report, the main conclusions of the EVPA study are integrated into the section on investment process (Part 4).

In order to help VPOs tackle the challenges of planning, delivering and valuing non-financial support, EVPA has developed a five-step model for managing non-financial support. In this report, the main conclusions from the five-step process are integrated into the section on investment process (Part 4).

As part of its investment strategy, the VPO should first consider the possible forms of non-financial support available to help the SPO advance on the three core areas of development (i.e. social impact, financial sustainability and organisational resilience). Based on

66. This section was developed based on the EVPA report on non-financial support: **Boiardi, P.,** and **Hehenberger, L.,** (2015), "*A practical guide to adding value through non-financial support*", EVPA.
67. **Hehenberger, L., Harling, A.,** and **Scholten, P.,** (2015), "*A practical guide to measuring and managing impact - Second Edition*", EVPA.
68. http://europa.eu/rapid/press-release_IP-14-696_en.htm
69. http://www.socialimpactinvestment.org/reports/Measuring%20Impact%20WG%20paper%20FINAL.pdf

3.5 NON-FINANCIAL SUPPORT

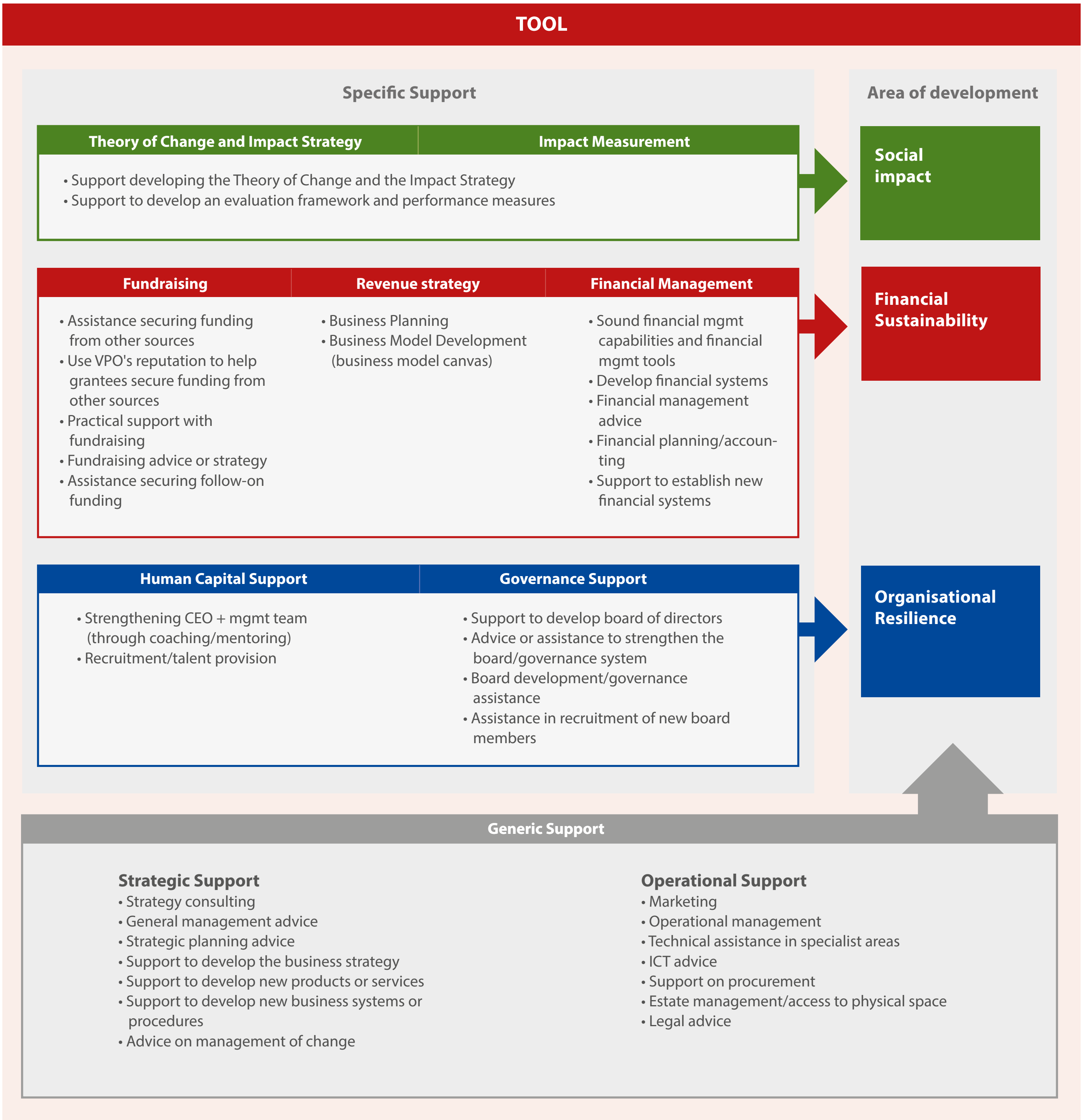
the VPO's own impact objectives and Theory of Change, i.e. the social change it wants to achieve through its investment strategy, the VPO can choose which types of non-financial support are ***core*** to implementing its strategy.

It is recommended that the VPO maps its assets, to assess who will provide the core and non-core support. The ***core*** support should be provided by the *VPO's internal team*, and only in case the issue is very technical and outside of the competences of the internal team by paid, low-bono or pro-bono consultants. The ***non-core*** support can be externalised to low-bono or pro-bono supporters or to paid consultants. The VPO also needs to consider how it will finance the non-financial support it provides and – in order to do so – it needs to have a clear view of the real cost of the non-financial support it is providing. The EVPA report *"A practical guide to adding value through non-financial support"*[70] provides practical guidance on how to monetise the cost of non-financial support.

70. **Boiardi, P.,** and **Hehenberger, L.,** (2015), *"A practical guide to adding value through non-financial support"*, EVPA.

3.5 NON-FINANCIAL SUPPORT

Figure 25: A mapping of non-financial support
Source: EVPA



3.5 NON-FINANCIAL SUPPORT

VP/SII Industry by the numbers: from The EVPA Survey 2013/2014[71]

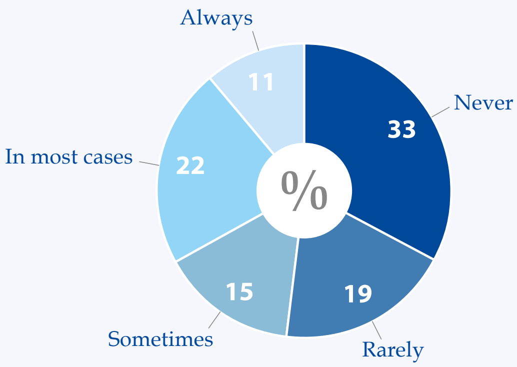


Figure 26:
Proportion of VPOs who measure [the spend on] non-financial support

n=95

Source: EVPA Industry Survey 2013/2014

The spend on NFS is difficult to quantify for a vast majority of the European VPOs. In the EVPA Survey 2013/2014, only 11% of the respondents always measures the spend on non-financial support, compared to a majority (52%) that never or rarely measures it.

Figure 27:
Non-financial support by % of respondents FYs 2011 and 2013

2013 n=94
2011 n=60

multiple choice
numbers in %

Source: EVPA Industry Survey 2013/2014

The respondents reporting data on their provision of non-financial support provide SPOs with a range of tailored services, including strategy consulting (81%), coaching (77%), access to networks (76%), financial management (65%) and fundraising (61%).

71. **Hehenberger, L., Boiardi, P.,** and **Gianoncelli, A.**, (2014), *"European Venture Philanthropy and Social Investment 2013/2014 – The EVPA Survey"*, EVPA.

3.6 The exit strategy[72]

We define an exit strategy as the action plan to determine when a VPO can no longer add value to the investee, and to end the relationship in such a way that the social impact is either maintained or amplified, or that the potential loss of social impact is minimised. The EVPA report *"A practical guide to planning and executing an impactful exit"* provides a five-step framework for the exit strategy (as shown below). In this report, the main conclusions are integrated into the section on investment process (Part 4).

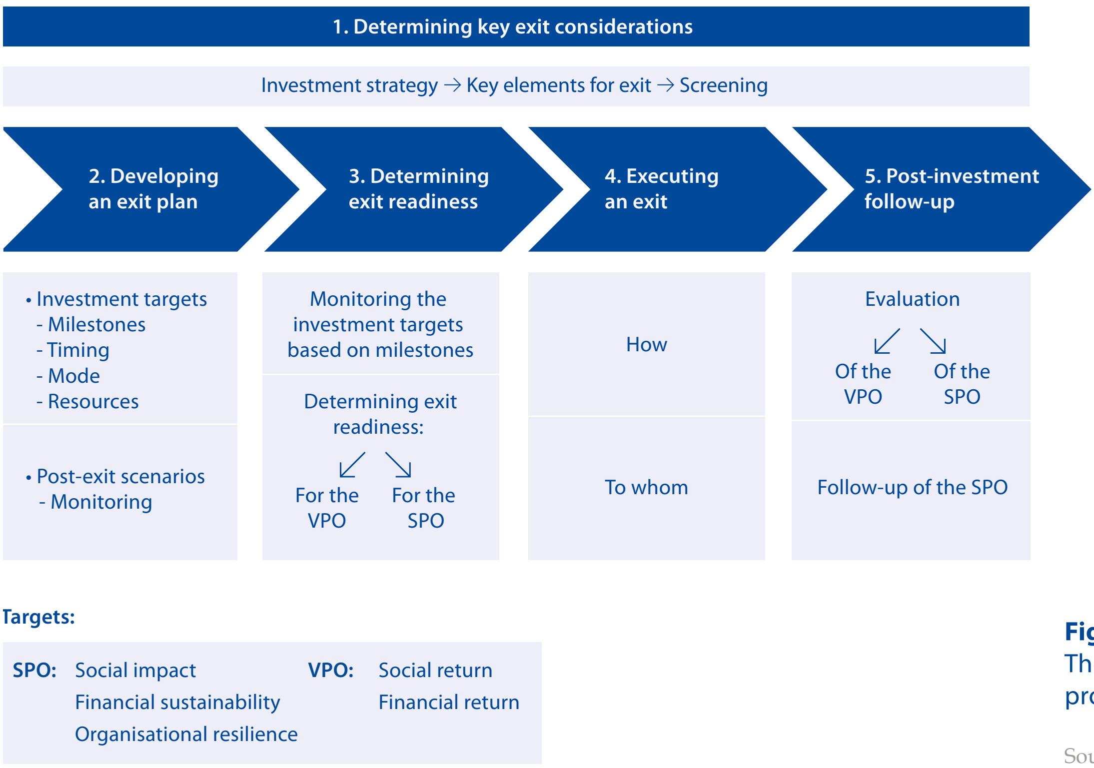


Figure 28:
The five-step exit strategy process

Source: EVPA

As part of the investment strategy, the VPO needs to think about how the exit strategy will guarantee the social mission of the investee is locked in, so that the SPO will continue pursuing its social impact goals even after the VPO has exited.

72. This section was developed based on the EVPA report on exit strategies: **Boiardi, P.,** and **Hehenberger, L.**, (2014), *"A practical guide to planning and executing an impactful exit"*, EVPA.

3.6 THE EXIT STRATEGY

Different options for locking-in the social impact include:

- ☑ developing new legal forms
- ☑ locking in the social impact through the business plan
- ☑ building the social mission into the organisational culture

Options for locking in the social impact of the SPO at the time of exit

The elements of the investment strategy that affect the exit strategy are as follows:

- **Context:** The geographical and the sector focus of a VPO determines the context in which both the SPO and the VPO operate and will therefore influence the exit strategy, especially in terms of whom to exit to and how to exit. In some cases, choosing to operate in a certain sector will reduce the exit options.
- **Type of investee:** The type of investee funded and the stage of development of the investee influence how the VPO exits, whom the VPO can exit to and the milestones the VPO and the SPO use to define exit readiness.
- **Type of funding:** Each investment modality (debt, equity or grant) will have different benefits/place different constraints on the exit strategy. Some investment structures will simplify exit, while others will pose some more challenges for both the investor and the investee at the time of exit. The investor needs to perform an overall assessment of the instruments it uses to finance the SPOs in its portfolio and how they influence the exit.
- **Co-investing:** Co-investors with a broad network that can be leveraged are a very important asset, especially at the time of exit. However, co-investors also create challenges. Before engaging with co-investors the VPO needs to assess the co-investors' investment strategy and objectives, financial/impact trade-offs and exit plans, to make sure they are compatible and aligned. A misalignment in the investment strategy of the co-investors can generate issues throughout the investment period and at the time of exit.
- **Relationship with VPO funders**: The way in which the VPO is funded impacts the investment strategy and as a result the key exit considerations. If funders have a strong influence on the investment strategy of the VPO, a sudden change in the investment strategy will result in the development of new key exit considerations.

3.6 THE EXIT STRATEGY

The **overarching social and financial objectives of the VPO** influence all the elements of the investment strategy, so they will also have an influence on the VPO's exit strategy. Some VPOs have a social sector focus and many have developed specific social impact objectives they would like to achieve in the social sectors where they operate. Financial return goals express the preference of the VPO in terms of return on investment (ROI) of the SPOs it invests in and the definition of how each investment is expected to contribute to the overall portfolio return.

Key Issues and Learnings

- **Clear focus** – The VPO needs to be clear at the outset about its objectives and its operating model. What areas of social need will it address? What types of organisation will it invest in? What types of financial instruments will it use?
- **Role of financial instruments** – Carefully selecting and applying the right funding instrument for a given organisation is part of the 'art' of VP investing.
- **Non-financial support is critical to the success of the VP approach** – Clearly defining which types of non-financial support are core to the VPO's strategy will help the VPO understand which resources it needs and which organisations it should invest in.
- It is important to consider which elements of the investment strategy will determine how the **exit strategy** is further developed.

Part 4:

The Investment Process

4.1 INVESTMENT APPRAISAL

For each investment, the VPO goes through an investment process as outlined below. This process helps maximising the achievement of the social and financial return objectives for the VPO at the time of exit. By properly managing the process, the VPO maximises its exit options and works towards enabling the most appropriate and impactful use of its resources. The VPO should plan, monitor and execute the investment and the exit with the final aim of leaving behind an SPO that has a stronger business model and organisational structure and that is capable of attracting and managing the resources necessary to pursue its social impact goal(s) in the long term.

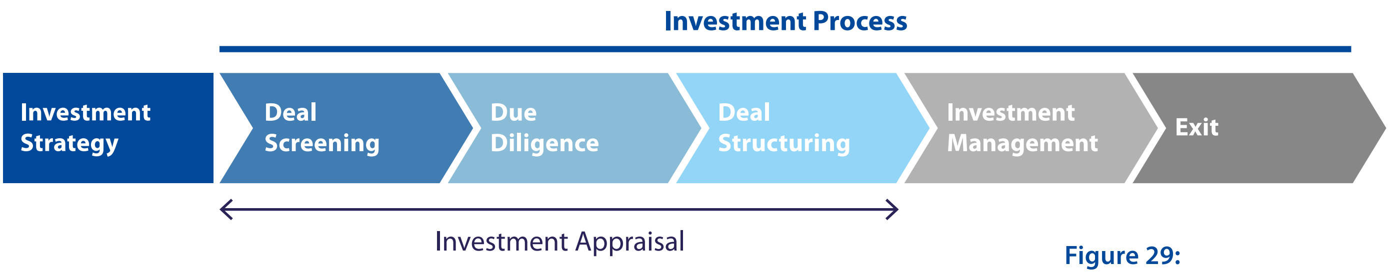


Figure 29: The investment process in VP/SII

Source: EVPA

After assessing the key elements of its investment strategy, the VPO screens the investments opportunities available (deal flow). After the first deal screening, a detailed screening (or due diligence) helps the VPO to decide which SPOs to invest in and decide how to structure the deal (deal structuring). The investment management both at SPO and VPO level follows the investment appraisal phase. When the VPO can no longer add value or when the investment objectives have been achieved, the relationship between the VPO and an investee organisation ends with an exit.

4.1 Investment appraisal

Different participants employ differing terminology for the investment appraisal process. It is advisable for the VPO to be aware of the time required by the SPO to undergo investment appraisal, and to ensure that the time used at each screening stage is proportionate to the potential benefit. While this is guesswork for a start-up fund, it can be established through independent investee feedback for more mature funds.

However, the key elements of the process are often similar and follow certain key steps:

Steps of the investment appraisal phase

- **Deal Screening**: A knock-out screening step for applicants who do not meet the standard application criteria. This will eliminate organisations that will definitely not secure funding. This is a preliminary screening procedure of the investment opportunities available (deal flow) – it requires initial application documents only.

4.2 DEAL SCREENING

- ☑ **Due Diligence**: Detailed screening usually resulting in the investment proposal presented to the investment committee for a final investment decision.
- ☑ **Deal Structuring**: A set of terms and conditions which specify how the agreement between the VPO and the investee SPO is to be concluded.

4.2 Deal screening

The first step of the appraisal process is a preliminary screening procedure of the investments opportunities available (deal flow), followed by a knock-out screening of the applicants that do not meet the standard application criteria (first screening).

4.2.1 Deal flow

Generating high-quality deal flow is one of the most important challenges a VPO will face and it should receive the same level of priority as fundraising. Even if this is not immediately apparent, the task is likely to be just as difficult. Planning for deal flow should therefore start around the same time as planning for fundraising. Finding early investment opportunities that offer a good fit to the VPO's objectives can be of crucial importance in securing investment. The type of investee that is the target of VP activity is sometimes hard to find. In many ways, VPOs have to take an active part in creating the market and good ideas may need to be incubated.

This section deals with the various issues related to deal flow. Due to the possible lack of suitable social purpose organisations available, *identifying and approaching target SPOs directly* is the recommended route for securing initial deals. According to the EVPA Survey 2013/14[73], 90% of the European VPOs chose this investee identification method. *Managing open funding applications* is another option, but it can impose significant administrative burdens without providing any guarantee of success. Managing an open application process can create a pool of disappointed applicants that can have a negative impact on the VPO's reputation. Moreover, the VPO has to decide whether to operate a 'gated' process, where it invites applications at specific times, or it has an always-open application process. The former can be very cost-effective in terms of generating and processing deal flow but it presupposes:

1. Good marketing channels for the VPO to broadcast its process;

2. A fairly mature SPO market where organisations will be open to respond to a gated process; and

3. A well-branded VPO, with an existing track record

73. **Hehenberger, L., Boiardi, P.,** and **Gianoncelli, A.**, (2014), *"European Venture Philanthropy and Social Investment 2013/2014 – The EVPA Survey"*, EVPA.

4.2 DEAL SCREENING

There are many ways of identifying potential investment targets[74]:

- ☑ Networking with intermediaries, other funders, and, in particular, potential co-investors with a deep knowledge of the field of interest (preferred investee identification activity by European VPOs, with 79% using this option)
- ☑ Speaking at sector-specific conferences (innovative approaches arouse interest – this option is used by 62% of European VPOs)
- ☑ Through existing portfolio organisations (these can be the best source, and it is used by the 59% of European VPOs)
- ☑ Through desk research (done by 47% of European VPOs)
- ☑ Connecting with VC funds that have dropped high-risk deals, which could be of interest (this is particularly relevant if your VPO focuses on social enterprise investments)
- ☑ Looking for SPOs implementing projects within the focus area of the VPO (this is relevant if your VPO has a sector or geographic focus)
- ☑ Organising business plan competitions (also more relevant to social enterprise – used by 32% of European VPOs)

Different ways of identifying potential investment targets

74. idem.

4.2 DEAL SCREENING

VP/SII Industry by the numbers: from The EVPA Survey 2013/2014[75]

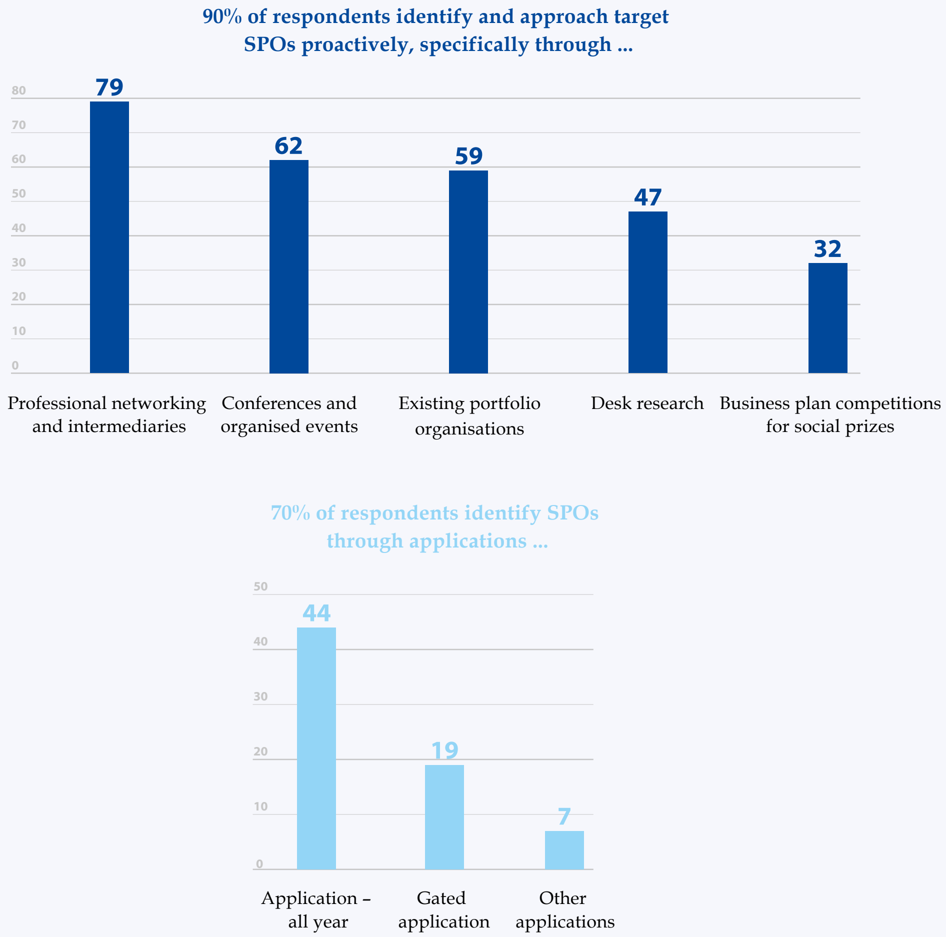


Figure 30: Investee identification activities

n=94
multiple choice
numbers in %

Source: EVPA Industry Survey 2013/2014

According to the EVPA Survey 2013/2014, 90% of VPOs are proactive in their search to identify and approach the SPOs to invest in, whereas 63% accept open applications. The latter increased from the latest data we had from FY 2011 when the percentage of European VPOs that accepted open applications was 43%. The application process is normally used in less developed markets or when the VPO has not yet developed its own network of potential SPOs to invest in. VPOs increasingly make contact through networking and intermediaries (79%, an increase of 9 percentage points compared to FY 2011), followed by conferences and organised events (62%, an increase of 14 percentage points compared to two years ago) and existing portfolio organisations (59%, an increase of 5 percentage points).

75. idem.

4.2 DEAL SCREENING

In addition to attracting deal flow, your VPO needs to define clearly the type(s) of investments it is looking for, as well as the selection criteria and the application process to employ.

Several other measures can help to optimise deal flow:

Measures that help optimise deal flow

- ☑ In the beginning, aim for quick wins by choosing low-risk deals. Some early success stories can help to secure financing. Deals that offer higher levels of social return will more likely flow once a robust, high-quality portfolio is in place.

- ☑ Working with a small group of aligned co-investors will significantly improve the quality of your deal flow. These may be foundations or trusts, other individual philanthropists, or a corporate or even a state funder. If the co-investors are older than your VPO, they will have an existing pipeline, relationships and market knowledge, all of which can save you time. However, be specific about what you are interested in and what you are not interested in. Make a 'what my fund will not invest in' list and circulate it widely.

- ☑ Select your marketing channels (but remember that word of mouth is the most powerful channel of all):
  - Website/web links/annual report of the VPO/publications/conference presentations, etc.
  - Current investees

- ☑ Casting the net widely (e.g. by publishing information and application forms on the web) may trigger many applications, but they may not be of the right quality. If you do communicate through the web about the projects you prefer to do, it is advisable to also communicate the type of projects you definitely **do not.** Also provide a case example of an ideal investment.

- ☑ Develop a clear positioning around your VPO's value-added services – and articulate this very clearly to SPOs. You will need to differentiate yourself from all other funding sources, including other philanthropies, state and corporate funders.

- ☑ Do not be afraid to focus on organisations that you already know - If rejected applicants have had a positive experience and have received some added value, they will refer you on to others (clearly communicating positive feedback and constructive criticism arising from due diligence can represent tremendous added value for an SPO; so can a referral by you to another funder).

- ☑ Provide a case example of an ideal investment, and include a "what we will not invest in" list on your website.

4.2 DEAL SCREENING

4.2.2 First screening

The impact objectives of the VP/SII will guide the deal screening step in the investment process, narrowing down the type of SPO that will be considered for investment. For each potential investment, it is important to evaluate the expected outcome of its investment in the SPO, i.e. the expected outcome of the SPO and how the VPO expects to contribute to achieving that outcome. To assess whether the potential investment opportunity fits with the VPO strategy, the VPO can ask questions detailed in Step 1 of the impact measurement process proposed by EVPA (Setting Objectives)[76], which are derived from the Theory of Change of the VPO and help guaranteeing alignment between the goals of the VPO and the goals of the SPO.

A two-step approach to first screening is recommended, with 'reject/continue' decision points after each step:

☑ Step 1: Desk screening of strategic fit between investor and investee
- Thematic focus
- Geography
- Investment size
- Social relevance/impact

☑ Step 2: Discussions with management to get acquainted and to get an overall view of the organisation and its activities, projects, partners, including a preliminary needs' assessment and whether the VPO can add value.

First screening: a two-step approach

The outcome of first screening is the basis for the initial decision by the VPO. Detailed screening will only be completed for organisations with a serious chance of securing investment. As such, it should not consume much time from the SPO.

The exit strategy of the VPO is an integral part of its investment strategy and aligning the exit strategy and the investment strategy is a crucial pre-condition for a successful exit. The key exit considerations developed in parallel to the investment strategy guide the VPO throughout the investment process and especially in the deal screening, i.e. in assessing which investment opportunities fit with the VPO's social impact and financial return goals (please refer to section 3.6)[77].

76. **Hehenberger, L., Harling, A.,** and **Scholten, P.**, (2015), *"A practical guide to measuring and managing impact – Second Edition"*, EVPA.
77. **Boiardi, P.,** and **Hehenberger, L.**, (2014), *"A practical guide to planning and executing an impactful exit"*, EVPA.

4.3 Due diligence

Detailed screening, sometimes referred to as due diligence, will usually be performed (at least in part) through analysis and validation of a business plan. Interviews with SPO management, staff and board, review of relevant documentation and focused research on external information sources will be of crucial importance:

Stakeholder analysis (i.e. Step 2 of the impact measurement process proposed by EVPA[78]) should be an integral part of the due diligence phase. To avoid wasting resources, it is advisable for the VPO to increase the intensity (i.e. more stakeholders, more involvement from the same stakeholders and higher numbers involved from each group up to the number required for a non-biased and random sample) of the analysis as it becomes more likely that the investment will be realised.

The detailed screening process will cover at least the following items:

☑ **Social Impact:**

- **Theory of Change** – What is the theory of change? It is vital to gain a detailed understanding of the current and expected social impact of the SPO. It not only reduces the risk of making the wrong investment, but also creates a common understanding of the impact of an organisation among all stakeholders and allows the VP/SII and SPO to 'speak the same language'. If a SPO is claiming a certain outcome then they need to prove it. If the SPO cannot deliver the data, the VP/SII must consider whether they will bring in the expertise and provide the necessary support so the data can be collected or question whether the SPO is an appropriate investment at all.
- **Impact measurement systems** – Track record of execution; impact measurement steps; social impact targets; monitoring and reporting on social performance. It is useful as part of the due diligence phase to check whether the impact monitoring system the SPO already works with is sufficient to meet the requirements of the VP/SII. Otherwise, the VP/SII may need to contribute to improving it through non-financial support and those costs should be factored in before making an investment decision.

☑ **Financial Sustainability:**

- **Market** – Market size, growth, developments, segments; relevant other initiatives/competitive positioning. The appeal of a specific SPO can also make the VPO overestimate the future development of a market: the recommendation here is to try to be prudent when making predictions about it.

Items to be covered during the due diligence

78. **Hehenberger, L., Harling, A.,** and **Scholten, P.**, (2015), *"A practical guide to measuring and managing impact – Second Edition"*, EVPA.

4.3 DUE DILIGENCE

- **Sources of income** – Funding trends and funding mix.
- **Financial** – History (results, previous financings); budgets and forecasts; funding gap/financial ask; co-financing; terms of investment, financial reporting and control process in place.

☑ **Organisational Resilience:**

- **Organisation** – legal structure; quality of management; governance; transparency of results, board quality. Dysfunctional SPO's boards are time-consuming and can constitute a major problem. Extensive reference checks on the management team are important not to overestimate the capabilities and the entrepreneurial spirit of the management team of the SPO.
- **Operations** – What the SPO does to deliver on its strategy, including details of the organisation's income-generating model, if relevant. A technical review of the appropriateness and solidity of the product or service the SPO delivers/performs may be a part of the process.

The detailed screening should deliver the key information needed to complete the investment appraisal process, including:

☑ Needs' assessment (to understand what type of non-financial support is needed and the status of development of the SPO in terms of social impact, financial sustainability and organisational resilience)[79]

☑ Risks related to the investment

☑ Potential mitigation measures (conditions for investment)

☑ Potential phasing of financing (milestones)

☑ Possibilities for scaling the initiative

☑ Involvement by VPO after investment

☑ Exit option(s) (see section 4.6)

Key information to be delivered by the due diligence

The time required by the SPO for detailed screening should be in direct proportion to the size of the potential investment. However, in practice, even small investments require substantial screening. VPOs should consider the minimum size of investment required to ensure that their own efficiency is not compromised.

79. EVPA's *"A practical guide to adding value through non-financial support"* provides a useful needs' assessment tool.

4.3 DUE DILIGENCE

VP/SII Industry by the numbers: from The EVPA Survey 2013/2014[80]

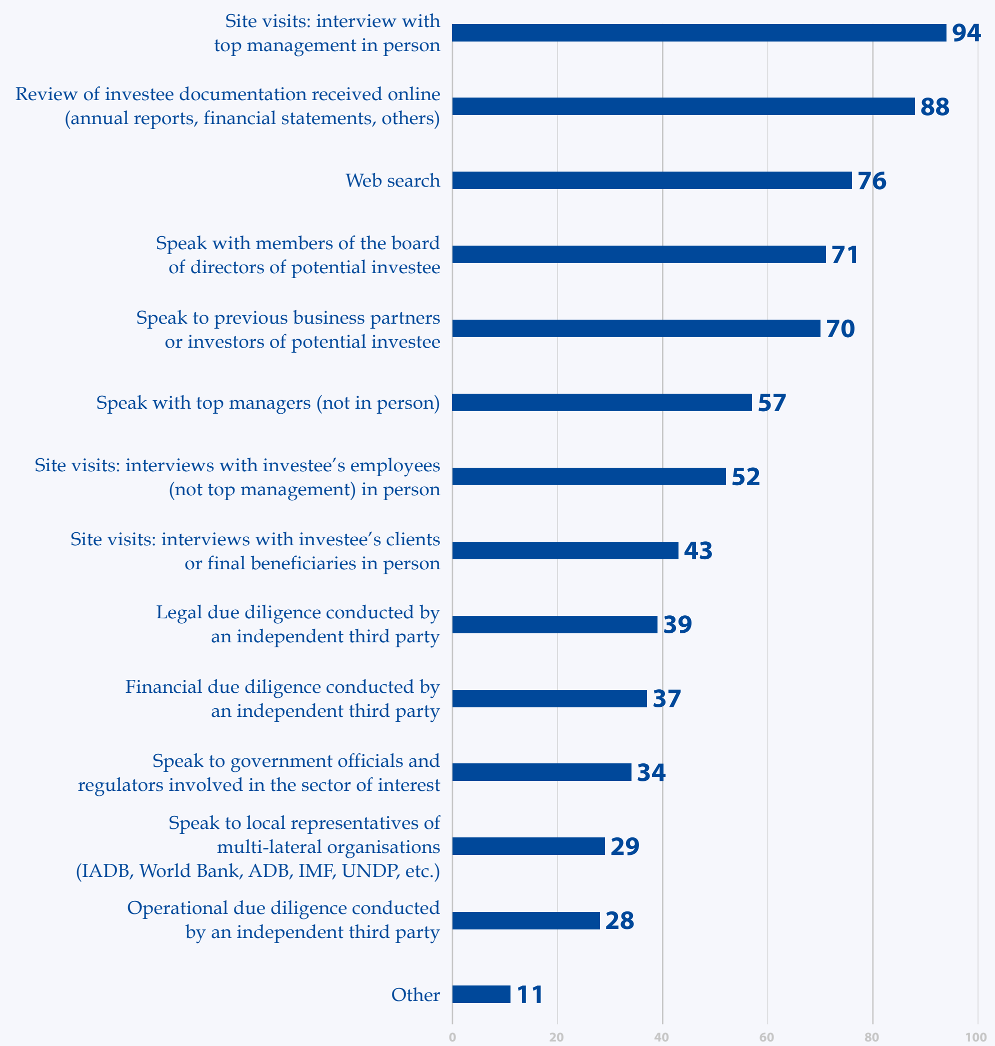


Figure 31:
Due diligence activities

n=93
multiple choice
numbers in %

Source: EVPA Industry Survey 2013/2014

The EVPA Survey 2013/14 shows that European VPOs are personally involved in due-diligence activities, with 94% of the respondents performing a site visit to interview top management in person. Performing general searches is done by the largest majority of the VPOs, with 88% of the survey respondents performing at least a review of the investee documentation received online and 76% of the respondents performing a general web search. Over 70% of the respondents meet with the key people in the SPO, speaking with the members of the board of directors and to previous business partners and investors of the SPO. Over almost half the respondents interview the employees in person and reaches out to the top management of the SPO, without meeting in person.

80. **Hehenberger, L., Boiardi, P.,** and **Gianoncelli, A.**, (2014), *"European Venture Philanthropy and Social Investment 2013/2014 – The EVPA Survey"*, EVPA.

4.3 DUE DILIGENCE

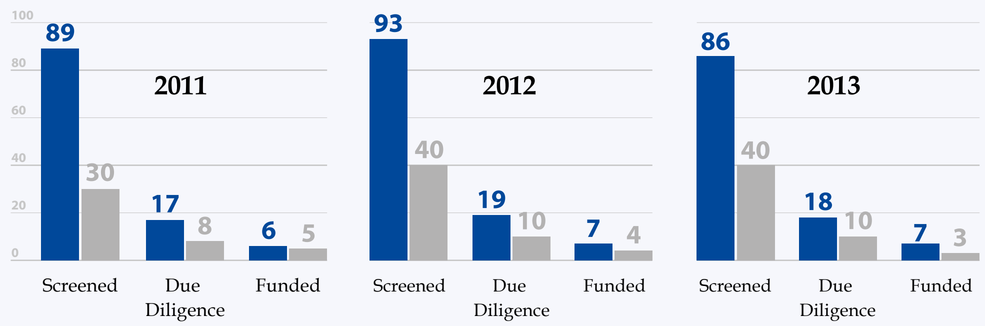


Figure 32:
Average and median number of SPOs screened, under due diligence and funded per VPO FYs 2011–2013

Average
Median

2013 n=77
2012 n=69
2011 n=56

Source: EVPA Industry Survey 2013/2014

On average, the VPOs performed due diligence on 21% of the screened organisations and selected 39% of the organisations that had gone through due diligence. The share of organisations that passed due diligence increased since last year, a result that may indicate an increase in the quality of the deal flow in the VP/SII sector. On average, a VPO will screen 86 organisations in a year, do further due diligence on 18 of them and select 7 investees.

The entire appraisal process, and the due diligence in particular, is a two-way process that will require cooperation between VPO and SPO, enabling each to see where and how they can add value (it is a learning process). We encourage transparency as many SPOs may not be familiar with practices that the investor may regard as a standard way of working that requires no explanation. Being involved in the appraisal process also creates commitment and a motivation for a positive outcome. The VPO should only engage in areas where it can add value and not seek to compensate for the target SPO's lack of resources. Notwithstanding this, outsourcing due diligence to a third party, or compensating the SPO for undertaking the task itself, creates a more arm's-length relationship and can make rejection decisions further down the line easier and more objective. Regardless of the level of involvement agreed, it will be important to spend time with the SPO's entire management team and board, to judge their quality and general 'buy-in' to the plan.

Building a close relationship between the two parties (culture and personality fit, mutual trust):

- ☑ Involves different management levels from each organisation
- ☑ Allows meetings to take place at different locations
- ☑ Allows experiences and expectations to be shared (results, timing, effort)
- ☑ Lays the basis for future cooperation

Advantages of building a close relationship between the VPO and the SPO

The extent of engagement during the appraisal process should be weighed against the level and form of engagement the VPO will adopt during the investment phase. In the appraisal phase the VPO and the target SPO should explicitly discuss the scope and style of their engagement during the investment phase. Potential forms of engagement available include active participation, reporting, co-ordinating engagement with other investments, taking a board seat (active or observer), etc.

4.4 Investment decision and deal structuring

The relationship that develops between a VPO's management team and the leadership of an investment candidate is a crucial factor in the investment decision, as the judgement of the quality of the leadership (non-profit CEO, social entrepreneur, etc.) and the executive team, enabling the VPO to build trust and confidence in the SPO's ability to deliver during the investment phase.

The interaction with the potential investee SPO will help to answer certain key questions:

- ☑ Is the leadership truly and deeply motivated by the mission of the organisation?
- ☑ Is it focused on maximising the organisation's social impact?
- ☑ Does it have a clear vision of where the organisation needs to be in three to five years – and how to get there?
- ☑ Does the leadership have the critical competencies and skills needed to execute its plans effectively?
- ☑ Does the board add value where needed?
- ☑ Can we work together?

Questions that will be answered thanks to the interaction with the potential investee

In many cases, there will be a need to develop and review a business plan for the target SPO. This can happen at different points in time, depending on the size and capabilities of the SPO. Larger, more established SPOs should be able to write their own plan. This ensures that the applicant maintains ownership of the plan and the objectives it contains, and that the social mission is built into the organisational culture so that at the time of exit there is no incentive to discontinue it.

If the SPO is capable of writing up its own plan, limited commitment will be needed from the investor, with the business plan acting as the starting point for first screening and discussions. However, other organisations will require assistance with business planning.

4.4 INVESTMENT DECISION AND DEAL STRUCTURING

The VPO should only assist in fields in which it can add value. In all cases, there should be a sense of joint development and ownership of the business plan, with objectives that incorporate the perspectives of each organisation. Cooperation in business planning creates commitment and buy-in from both sides. Co-developed business plans are generally developed after the first screening analysis and discussion has been completed (i.e. there has been a preliminary approval).

When deciding about investments, the recommendation in general is to avoid investments in SPOs with high product/service risk; in sectors or geographies that the VPO does not know or where the risk of not creating impact is too high; investments too quick or only to fill quotas, without adding strategic value; or finally in SPOs not ready for the VP approach[81].

To reduce the risks of failures in deal selection, the VPO should consider undertaking stepped investments[82] in target SPOs. The VPO can 'test the water' with new organisations by completing small investments initially as:

- This can limit risk and minimise failure.
- Seeding multiple SPOs through small capacity building investments or donations can allow a VPO to 'get to know' the organisations and test them without risking too substantial funds.

Managing negative decisions is another important part of the investment process. The VPO should build in several evaluation and decision-making steps within the overall appraisal process, so that it can, where necessary, refuse funding at an early stage. The applicant should be made aware of each step in the decision-making process, and the key criteria considered at each step. One challenge in deal selection is to say no (an early no) to appealing but unpromising ventures. Even more difficult – and of utmost importance – is to distil this skill into a code of practice that is to develop the knowledge and skills to have a feeling for what is right, a sort of screening skills apprenticeship. To achieve this ability, it is necessary to build up experience – and experience stems from attempts[83].

If and when a positive decision on the investment is made, understandings and agreements should be laid down in an investment contract between the VPO and the SPO. Before this is finalised, legal due diligence may be performed to eliminate, where possible, the risk of any further obstacles or surprises.

Ideally, when the deal is structured, apart from financial considerations, the VPO and SPO should work together to develop a **plan** that allows the VPO to work towards an exit (**exit plan**), and a plan where the development needs of the SPO and the main aspects of the non-financial support have been identified (**non-financial support plan**).

81. **Hehenberger L.** and **Boiardi, P.,** (2014), *"Learning from failures in Venture Philanthropy and Social Investment"*, EVPA.
82. Incremental investments to the same investee.
83. **Hehenberger L.** and **Boiardi, P.,** (2014), *"Learning from failures in Venture Philanthropy and Social Investment"*, EVPA.

4.4 INVESTMENT DECISION AND DEAL STRUCTURING

4.4.1 Non-financial support plan[84]

When the deal is signed, the VPO and the SPO discuss and develop the non-financial support plan. For each development area that has been agreed as priority to tackle, including impact measurement, the non-financial support plan should include the base-line, goal, milestones, and target outcomes for the SPO, along the dimensions of financial sustainability, organisational resilience and impact objectives.

The plan should also include the **details of the support** the VPO will provide to the SPO to achieve the planned milestones, and the concrete deliverables, e.g. have a governance system in place.

The resources of any SPO are limited and decisions have to be made about the amount of time and resources that a SPO should dedicate to **impact measurement**[85]. An important role of the VPO is to convince the investees of the value of impact measurement, provide assistance where possible and define with them the responses to the essential questions to help them express their objectives. Defining in the initial stages of the relationship with the SPO exactly what it wants to deliver makes it much easier at a later stage to assess whether this has been achieved. To remove a reliance on and/or culture of 'gut feeling', it is essential that the VPO works with the SPO to develop an impact monitoring system which can be integrated into the management processes of the organisation, defining timings for each indicator (as not all impact happens at the same time), tools to be used and responsibilities. The cost to support and maintain such a system (including personnel time and costs) should be part of the SPO's budget and hence may be part of the negotiation with the investor in order to decide how costs should and/or could be split.

At the deal structuring phase it is important to clarify **who is responsible for measuring what**. The responsibilities of who measures what could and probably should evolve over time as the SPO grows and develops and should be reviewed on an annual basis. For impact measurement the expected outputs, outcome and impact, and the corresponding indicators should be defined before the investment is made and agreed upon by the VPO and the SPO. The VPO should ask the SPO to focus on those indicators that are directly related to the SPO's Theory of Change and hence in line with their operational process. Any additional indicators required for the VPO to satisfy its own impact measurement needs should be collected by the VPO. Similarly, for the objectives in terms of financial sustainability and organisational resilience, the VPO and the SPO need to agree on what data will be collected during the investment management phase and how the SPO will be able to give feedback on the non-financial support provided.

Reporting requirements should also be agreed upfront between the VPO and the SPO, preferably involving co-investors in the decision-making process to eliminate a multiple reporting burden for the SPO. Managing expectations about frequency and level of detail for reporting, and the way the SPO reports will reduce the risk of problems later on in the process.

84. This section was developed based on the EVPA report on non-financial support: **Boiardi, P.,** and **Hehenberger, L.,** (2015), *"A practical guide to adding value through non-financial support"*, EVPA.

85. **Hehenberger, L., Harling, A.,** and **Scholten, P.,** (2015), *"A practical guide to measuring and managing impact – Second Edition"*, EVPA.

4.4 INVESTMENT DECISION AND DEAL STRUCTURING

4.4 INVESTMENT DECISION AND DEAL STRUCTURING

Figure 33: The non-financial support plan

Source: EVPA

TOOL									
Capability	Derived from discussion **on needs' assessment** in Step 2 (matching VPO's and SPO's views)					Monitoring (for Step 4)	Derived from **needs' assessment** (Step 2) and **NFS mapping** (Step 1)	From the **VPO's asset mapping** (core vs non-core) in Step 1	Monitoring (for Step 4 and Step 5)
	Specific need of the SPO	Priority for SPO? (1 to 3)	Baseline	Goal	Milestone	Outcome	Mapping NFS needed to achieve milestone / objective	Who provides it?	Deliverables
			Social Impact					**Social Impact**	
Theory of Change and Impact Strategy									
Impact Measurement									
			Financial Sustainability					**Financial Sustainability**	
Fundraising	The SPO has limited access to multiple categories of funders	1	70% of SPO revenues coming from VPO's investment	<30% of SPO revenues coming from VPO's grant	50% of SPO revenues coming from VPO's grant by the end of year 1		• Assistance securing funding from other sources • Networking with potential funders and government • Practical support with fundraising • Fundraising advice or strategy	Core and in-house expertise → VPO staff	
Revenue Strategy									
Financial Management	The SPO has limited financial plans & monitoring	2	Financial planning and reporting tool insufficient	Fully fledged financial planning and reporting system in place by the end of the financing period	Have a version of tool X tailored to the SPO CFO capable of using the tool by the end of year 1		• IT support to develop the tool in line with the needs of the investee • Train the CFO to use the tool	Core but very specialised → External paid consultant	Tailored to by [DATE] CFO training: 2 days / month for 5 months
			Organisational Resilience					**Organisational Resilience**	
Governance Support									
Human capital Support									

4.4 INVESTMENT DECISION AND DEAL STRUCTURING

Both SPO and VPO should formally engage in fulfilling their part of the non-financial support plan, and to flag potential issues or problems as they arise, allowing the plan to be flexible. It is good practice to present the non-financial support plan as a part of the documents signed in the deal structuring phase, so that it represents a 'charter of engagement', which can be used by both parties as a pressure point towards the other to ask for delivery of results or of support.

4.4.2 Exit plan[86]

On top of the non-financial support plan, the VPO and the investee should discuss and co-develop an exit plan upfront. The exit plan allows the two parties to clarify the key points related to the exit, which include the general goals of the investor (related to the financial, organisational and impact milestones of the investment), the expectations of both parties and the timing of the exit. The aim is to maximise the transparency of the relationship between the investor and the investee and to clarify expectations. The exit plan must be matched with the deal structuring, and the resources necessary to monitor the investment and to roll out the overall exit plan need to be allocated.

Figure 34:
Key elements of an exit plan

Source: EVPA

86. This section was developed based on the EVPA report on exit strategies: **Boiardi, P.,** and **Hehenberger, L.,** (2014), "*A practical guide to planning and executing an impactful exit*", EVPA.

4.4 INVESTMENT DECISION AND DEAL STRUCTURING

The key elements of the exit plan are:

- ☑ Investment goals of the VPO – as derived from the key exit considerations
- ☑ Goals of the SPO and milestones – as defined in the non-financial support plan, used to help determine when exit readiness is achieved
- ☑ Timing of the exit – i.e. the investment horizon, which largely depends on the flexibility offered by the financing instrument used
- ☑ Mode of exit – including how and whom to exit to, both of which largely depend on the financing instrument used
- ☑ Resources – to monitor the investment and roll out the exit plan (should be included in non-financial support plan)
- ☑ Exit market scenarios – in which the VPO tries to predict whom it will exit to and what the market will be like at the time of exit

Key elements of the exit plan

The development of the exit plan is a joint effort of the VPO and the SPO, and the goals and milestones should be formalised and included in a Memorandum of Understanding (MoU). The exit plan needs to be detailed and clear (including when the VPO will exit, how and to whom), but also needs to provide sufficient flexibility (and liquidity) to be able to react to deviations.

VP/SII Industry by the numbers: from The EVPA Survey 2013/2014[87]

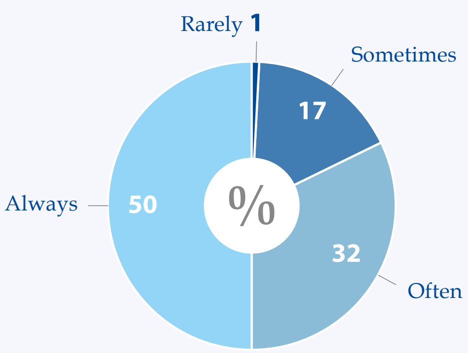


Figure 35:
% of VPOs that involve the investee in the development of the exit plan

n=60

Source: EVPA Industry Survey 2013/2014

The statistics from the EVPA Survey 2013/14 confirm the importance of engaging the SPO in the development of the exit plan. Co-creation generates commitment and ownership in the SPO and improves the whole exit strategy process. Half of the VPOs surveyed always involve the SPO in the development of the exit plan, and 32% asserts to involve SPOs often. Only 1% of the VPOs involve the SPO rarely in the development of the investment plan of their investment strategy to derive key exit considerations.

87. **Hehenberger, L., Boiardi, P.,** and **Gianoncelli, A.**, (2014), *"European Venture Philanthropy and Social Investment 2013/2014 – The EVPA Survey"*, EVPA.

4.5 INVESTMENT MANAGEMENT

4.5 Investment management

The management of the VPO investments is closely connected to the size of its portfolio, i.e. the number of SPOs supported. Investment management for VPOs operates on two levels: at the level of each investee SPO, and at the level of the portfolio as a whole.

4.5.1 Size of portfolio

A defining characteristic of VPOs, especially as compared to many pure grant-makers, is the relatively small size of the portfolio of organisations being actively supported at any time. However, in choosing the size of their portfolios, VPOs will also be guided by the need to have a minimum number of investments to provide a sufficient spread in terms of investment risk and to demonstrate that their investment model works in a variety of situations. Interestingly, the EVPA Survey 2013–2014 shows a sharp increase in the average number of investees per VPO in FY 2013 compared to FY 2012 (see the Box "*VP/SII industry by the numbers*", below). These results could be driven by the increase in the size of VPOs' funds and the economies of scale that can be generated by investing through bigger funds. The portfolio size will be determined by the size of the fund, the average size of the target organisations and the average level of support needed (taking into account the need to avoid financial dependency).

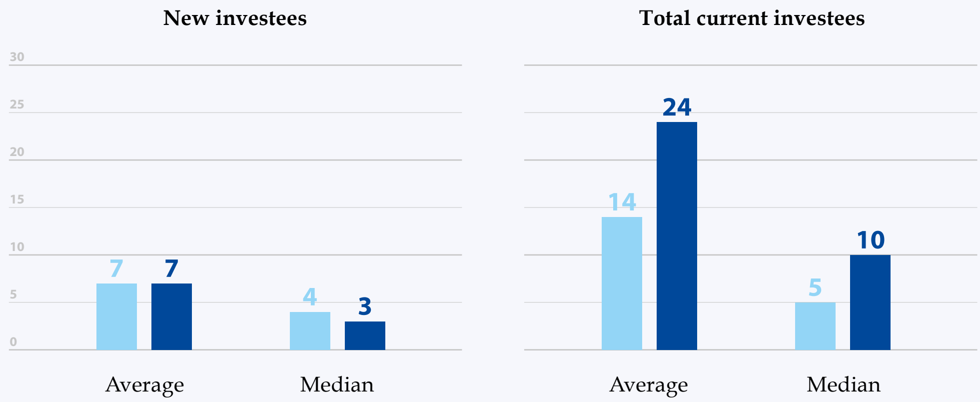
However, there are other factors to consider:

Factors to consider when assessing the size of the portfolio

- ☑ Is the relationship limited to a single 'investment round' or will follow-on funding be needed? The term of the initial investment and the stage of development of the investee can influence this question.
- ☑ The cost (internal or external) of any non-financial support to be provided to the SPO.
- ☑ The value of leverage – the exchange of knowledge and experience between portfolio organisations can lead to the creation of significant additional value with little or no additional cost. Building the portfolio selectively can drive the emergence of this incremental value.
- ☑ A large number of small portfolio companies will, in general, consume more support costs (fund management costs) than a small number of large portfolio companies, without necessarily generating any additional impact.

4.5 INVESTMENT MANAGEMENT

VP/SII Industry by the numbers: from The EVPA Survey 2013/2014[88]



For FY 2013, the average number of SPOs in the portfolio of a VPO was 24, a 71% increase compared to FY 2012, and the median number was 7. The average number of new investee organisations added to the portfolio in FY 2013 was 10 and the median was 3.

Figure 36:
Median and average investees per VPO FYs 2012 and 2013

2013 n=78
2012 n=72

Source: EVPA Industry Survey 2013/2014

4.5.2 Investment management at the SPO level

The plan for the investment phase engagement should be discussed and agreed with the SPO during the investment appraisal process, to ensure there are no surprises.

The key elements of the investment management strategy should include:

- ☑ Agreed social outcomes/targets and targets for the organisational development of the SPO
- ☑ The nature of the relationship (ideally based on openness, partnership and trust)
- ☑ Rights and obligations of both parties
- ☑ Frequency of meetings (generally monthly or half-yearly)
- ☑ Right of the VPO to appoint a board member or not (see below)
- ☑ Funding plan (including co-investment) with key milestones
- ☑ Key areas for capacity building or adding value (see section 4.4.1)
- ☑ Exit planning (see section 4.4.2)

Key elements of the investment management strategy

88. **Hehenberger, L., Boiardi, P.,** and **Gianoncelli, A.,** (2014), *"European Venture Philanthropy and Social Investment 2013/2014 – The EVPA Survey"*, EVPA.

4.5 INVESTMENT MANAGEMENT

As mentioned in section 4.4, these issues should generally be set out in an investment agreement with the SPO in order to limit future misunderstandings or disappointments.

4.5.2.1 Taking a seat on SPOs' board

Many European VPOs take a seat on the SPO board in at least some of their investments. Initially, it was very difficult to secure a board seat, but the practice has become more acceptable as the added-value dimension has become more recognised. Often, especially in start-ups, VPOs take an active board seat that can almost be likened with co-entrepreneurship. In those cases, VPOs do not manage, but are involved in all major decisions. There are two key questions that will drive the VPO's preferences on board representation:

- Can we really add value to the board and is it useful for us?
- Do we have the capacity to do this?

The decision will often depend on the size of the investment and its importance within the VPO's overall portfolio. In addition, VPOs considering taking a board seat will need to think about how they will handle conflicts of interest (when re-investment is on the agenda, for example). The VPO should try to anticipate such situations upfront and plan its approach accordingly. Using different people to take on the roles of portfolio manager and board representative can help. EVPA has developed a code of practice that can serve as a useful guide in taking board seats – it can be found in the membership section of our website.

Taking a board seat is not the only way to learn about or influence an SPO's activities. In some cases it may be adequate to have an 'observer' seat on the board. This can be a good compromise when there is resistance from the SPO to the VPO taking a full seat. A VPO may also be able to achieve its objectives by introducing external people to the board as opposed to taking a seat itself. If a third party is appointed to the board through the VPO's introduction, it is important to spell out that person's role: does he or she have any obligation to the VPO? Is the board member formally the VPO's representative, with an obligation to report on what happens at board meetings?

Some European VPOs actively decide not to take a seat on the SPO board. For instance, Impetus Trust[89] in the UK initially chose not to take a board seat in order not to confuse its role as a VP funder and the role of charity board as fundraiser. Impetus Trust thought a presence on the board would have reduced the motivation to raise additional funds. In 2002, there was a lot of suspicion around private sector people entering the social sector, and Nat Sloane recalls that Impetus thought it could 'spook' the boards. This was probably a misjudgement. Impetus-PEF now has a staged process, working with the investee for around a year to get to know the organisation. There is no board seat at this stage but Impetus-PEF communicates that in the next stage it would want a board seat. The SPOs then move through a 'funnel' model, where only a certain number progresses through

89. Impetus-PEF after the merger between Impetus Trust and the Private Equity Foundation in 2013.

4.5 INVESTMENT MANAGEMENT

each subsequent stage of investment all the way up to scale funding. Impetus-PEF may ask for a board seat so as in later funding stage. So far Impetus-PEF has insisted that investment directors are not the ones taking the board seat so as not to complicate the relationship between investment directors of the VPOs and CEOs of the SPOs. If a VPO is genuinely committed to a long-term partnership and impact, why not be on the board?[90]

VP/SII Industry by the numbers: from The EVPA Survey 2013/2014[91]

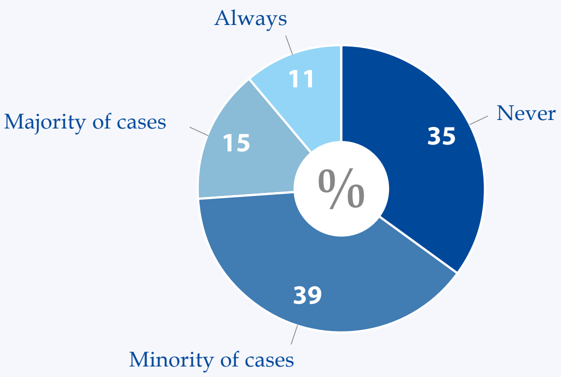


Figure 37:
% of investees where the VPO takes a board seat

n=93

Source: EVPA Industry Survey 2013/2014

Similar to the approach in venture capital, some VP/SII organisations often take board seats in their investees to affect the strategic direction from within. However, the percentage of VP/SII organisations that always or in a majority of cases take a board seat is only 26%. A striking 35% of respondents never take a board seat, and 39% take board seats in a minority of cases.

4.5.2.2 Monitoring the achievement of the goals set in the non-financial support plan[92]

A **monitoring** of the progress of the SPO against the objectives set in the non-financial support plan needs to be conducted regularly during the investment process. Some indicators may be reported by the SPO more frequently than others. For the impact measurement system, typically, output indicators can be captured more frequently than outcome indicators that might require more time and effort to collect relevant data. VPOs usually require their investees to report against the predefined indicators every quarter, every six months or on an annual basis during the investment period.

Stakeholder analysis may need to be repeated either at predefined intervals during the investment period or when significant developments occur, such as a change to outcomes being achieved, major new funding streams, new business lines being entered, changes to policy environment, etc. It is advisable to get back to the key stakeholders to verify that their expectations are being met. Verifying and valuing results should be repeated as a 'reality check' at several points during the investment and value creation process of a VPO. We recommend that this step be performed at least once during the investment period to check that the impact is achieved and valued.

90. **Hehenberger L.,** and **Boiardi, P.,** (2014), *"Learning from failures in Venture Philanthropy and Social Investment"*, EVPA.

91. **Hehenberger, L., Boiardi, P.,** and **Gianoncelli, A.,** (2014), *"European Venture Philanthropy and Social Investment 2013/2014 – The EVPA Survey"*, EVPA.

92. **Boiardi, P.,** and **Hehenberger, L.,** (2015), *"A practical guide to adding value through non-financial support"*, EVPA. And **Hehenberger, L., Harling, A.,** and **Scholten, P.,** (2015), *"A practical guide to measuring and managing impact – Second Edition"*, EVPA.

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The main objective of monitoring is to learn from the data collected and analysed so that changes can be made and corrective actions implemented. The VPO together with the SPO should use the data collected to analyse the results against the initial objectives and decide which strategies and interventions worked and which did not. The indicators set at the deal structuring stage can be revised if significant changes are made in the business and impact model of the SPO during the investment process.

4.5.2.3 Non-financial support delivery models[93]

The VPO delivers non-financial support through a variety of delivery modes, including through one-on-one coaching, group trainings and offering access to networks. Each delivery mode has its pros and cons, which need to be weighted before taking a decision on how each type of non-financial support is to be delivered. The development of the SPO is monitored using the non-financial support plan as a dashboard and corrective actions are implemented, if need be. The non-financial support plan shall also highlight when it is time for ending the relationship between the VPO and SPO. The VPO and the SPO need to clarify upfront how heavily the VPO will be engaged with the SPO and set the targets that will determine if exit readiness has been achieved. Non-financial support will be delivered until the desired impact is seen, or until the VPO realises it cannot add any more value to the SPO.

4.5.2.4 Determining exit readiness[94]

The VPO monitors the investment based on the exit plan co-developed with the investee. The SPO cooperates with the VPO by providing information on the status of development of the project and on the achievement of the goals set in the plan. The monitoring is crucial, as it allows the VPO and the SPO to take action in case of deviations from the original exit plan.

Based on the monitoring, the VPO and the SPO determine if readiness is reached relative to the planned date of exit.

Exit readiness is measured along three dimensions:

Social impact	The social change on the target population resulting from an SPO's actions.
Financial sustainability	The assessment that an SPO will have sufficient resources to continue pursuing its social mission, whether they come from other funders or from own revenue-generating activities.
Organisational resilience	The assessment of the degree of maturity of an SPO, in terms of the degree of development of the management team and organisation (governance, fund-raising capacity etc.).

Figure 38:
The three dimensions of exit readiness

Source: EVPA

93. **Boiardi, P.,** and **Hehenberger, L.,** (2015), "*A practical guide to adding value through non-financial support*", EVPA.
94. **Boiardi, P.,** and **Hehenberger, L.,** (2014), "*A practical guide to planning and executing an impactful exit*", EVPA.

4.5 INVESTMENT MANAGEMENT

It is important that the SPO reaches the goals on all three dimensions because a strong, financially viable organisation is the pre-requisite for the long-term achievement of the social impact goals.

The VPO also considers exit readiness from the perspective of its own social impact and financial return goals.

At the moment of determining exit readiness, five scenarios are possible:

1. Readiness is reached or partially reached, to the point that the VPO can no longer add value to the investee. In this case the VPO can exit the investment according to plan.

2. Readiness is reached or partially reached, to the point that the VPO can no longer add value to the investee, but investment readiness is not reached. In this case the VPO can:
   a. Invest more resources to bridge the gap between exit readiness and investment readiness
   b. If there is no market for the SPO, let go.

3. Readiness is reached or partially reached, and the VPO feels it can still add value to the SPO. In this case the VPO re-invests in the SPO taking it to the next level.

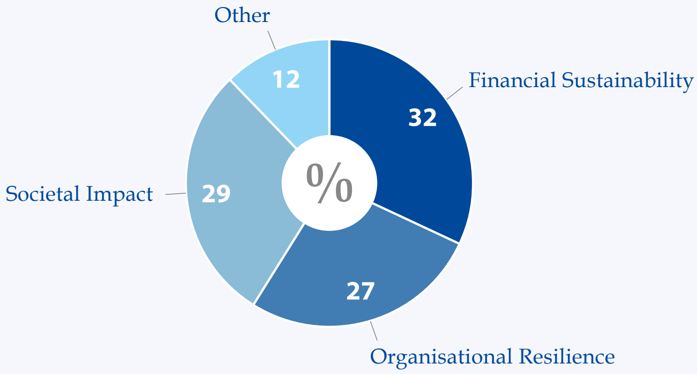
4. Readiness is not reached or only partially reached and the VPO feels it can still add value to the SPO. In this case the exit strategy process needs to go back to step 2: the VPO and the SPO need to develop a new exit plan.

5. Readiness is not reached and the VPO cannot add more value to the SPO. In such case the VPO needs to accept the failure and let go, while trying to minimise the loss of social impact.

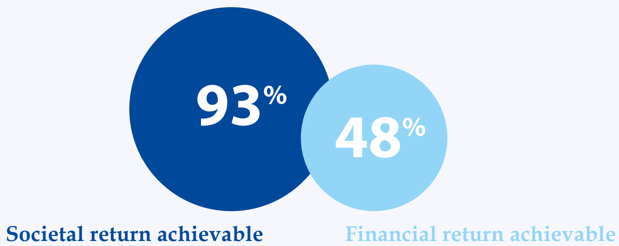
Determining exit readiness – five scenarios

4.5 INVESTMENT MANAGEMENT

VP/SII Industry by the numbers: from The EVPA Survey 2013/2014[95]



Financial sustainability is stated by roughly one-third of VPOs (32%) to be the most important dimension of exit readiness of the investee, followed by societal impact (29%) and organisational resilience (27%). This result points to the fact that follow-on investors are increasingly interested in SPOs that are reaching break even or self-sustaining and that VPOs consider their job done when the SPO is not only exit ready but also investment ready, i.e. attractive for follow-on investors.



Almost all VPOs (93%) consider societal return crucial for determining the achievement of exit readiness, while less than a half of the VPOs surveyed consider readiness to be achieved on the VPO side if the financial return goals have been achieved.

Figure 39:
Relative importance of the three dimensions of the SPO's exit readiness

n=62
weighted average

Source: EVPA Industry Survey 2013/2014

Figure 40:
Relative importance of the two dimensions of the VPO's exit readiness

n=60
multiple choice

Source: EVPA Industry Survey 2013/2014

Building a good relationship with the SPO during the appraisal process is crucial to making a success of the investment phase. The most successful relationships will be based on mutual trust and respect, not on legal documents and fear of funding being withheld. To achieve social innovation the VPO has to allow for an element of risk, therefore giving the SPO the 'permission to fail', while trying to mitigate the risks of failing. By acknowledging and accepting this condition, the VPO can act to support the SPO and help it not to fail[96].

95. **Hehenberger, L., Boiardi, P.,** and **Gianoncelli, A.,** (2014), *"European Venture Philanthropy and Social Investment 2013/2014 – The EVPA Survey"*, EVPA.
96. **Hehenberger L.,** and **Boiardi, P.,** (2014), *"Learning from failures in Venture Philanthropy and Social Investment"*, EVPA.

4.5 INVESTMENT MANAGEMENT

Open engagement with the SPO is the best possible means of obtaining early visibility of problems. An open engagement can be maintained in several ways:

- ☑ Board representation or observer position (see section 4.5.2.1)
- ☑ Regular (e.g. monthly or quarterly) progress meetings with SPO management and staff
- ☑ Regular financial and social performance reporting

Ways to maintain an open engagement with the SPO

When things go wrong the first reaction of the VPO should be "How can we help?" rather than "Should we stop the funding?" or "Who is to blame?". However, VPOs should avoid the temptation to try to solve problems simply by making more funds available – this approach may actually exacerbate problems in some instances. Sometimes, the most appropriate form of action may be to leverage your networks, provide specific market intelligence to the SPO or even just offer moral support.

To avoid any potential misunderstanding when problems do arise, it is essential to set out in advance a process for dealing with underperformance. This should be part of an overall culture or environment in which openness and honesty are rewarded – so that the SPO reports to the VPO as a matter of course, even when results do not match expectations. Establishing an environment that provides early visibility of problems will also allow for early identification of corrective measures.

Any potential solution that involves additional funding should be treated as a new investment decision – meaning that the VPO's investment appraisal process is applied in the usual fashion. It should be absolutely clear to the investment committee that the risk/return profile of this investment (in social and financial terms) matches with the VPO's regular criteria. Possible co-funders can be included in this process. It is important not to let emotion cloud judgment. Personal commitment to investees and their objectives can tempt funds to extend additional finance without a full consideration of the merits of the deal.

In the most severe cases, when the situation has deteriorated to such an extent that additional funding is needed but cannot be justified, the funders will take a decision to stop financial support. In these instances, the VPO should consider whether it has a responsibility to help wind down the SPO responsibly. This might involve the provision of some additional funds in the short term.

It is important to recognise that the VPO's influence depends in part on how much of the SPO's funding it supplies. It may be able to influence other funders with a similar agenda (e.g. other grant makers – see co-investment, section 3.4) but other funders, such as government agencies, may have conflicting objectives.

4.5 INVESTMENT MANAGEMENT

4.5.3 Investment management at the VPO level

A maturing VPO will have a number of SPOs in its portfolio, all of which will be – or should be – operating within the VPO's focus area. VPOs that have been active for several years will need to acknowledge the greater need for portfolio management rather than just individual investee management, managing more investee organisations in larger portfolios.

In managing the portfolio, some aspects should be taken into account:

- ☑ Flagship investments: Since VP is an emerging practice, selecting investments in well-recognised and reputable SPOs can be a valuable way to build credibility in the sector and provide leverage for future investment activity. This will be a particularly useful strategy for new funds that are starting to build a track record.

- ☑ Leverage: It will enhance the mission of the VPO as a whole, as well as the prospects of individual portfolio SPOs, when investments are made in organisations that complement each other rather than compete against each other. This approach creates the possibility to leverage knowledge and experience. These opportunities for cross-SPO leverage should be pursued actively – they should be identified and documented during the investment appraisal process.

- ☑ Competition for resources: Inevitably, portfolio SPOs will compete for resources – both funding and support – within the VPO. Good account management can help to minimise any problems that arise.

- ☑ Facilitation: Portfolio managers should be encouraged to create links between portfolio SPOs that have the same client base, for example, or that share the same suppliers. Regular meetings with all portfolio organisations, or a relevant subset, will enable experiences to be exchanged.

- ☑ Feedback from SPO: In addition to routine communication, VPOs with a portfolio of investees can commission independent feedback on the perceived effectiveness of investment model and portfolio management practices, e.g. the value to the SPO of investment appraisal processes, reporting processes, and non-financial value add. The Euro return on time invested in investment appraisal can also be measured. It is also possible to benchmark these against other VPOs. This has provided valuable lessons to some European funds[97]. EVPA and AVPN are planning to launch a project to assess the value of the VPO support on their investees.

Aspect to consider when managing the portfolio

97. One Foundation commissioned independent feedback from their grantees through a quantitative survey, carried out by Centre for Effective Philanthropy in Boston. An independent evaluation of Inspiring Scotland's portfolio companies was performed by Noah Isserman.

- VPO's cost efficiency: It is vital to track whether the VPO uses its resources efficiently. This is a critically important area to track as VPOs need to report to their funders/investors. As VPOs mature, and need to broaden their investor/funder bases beyond founder and early-stage funders, measuring cost efficiency becomes increasingly important. It is valuable for VPOs to start thinking about what to track and how to report on this right from the start of the journey.

- VPO's impact measurement[98]: For a VPO, it is not enough to just consider the impact achieved by the SPO, it is also important to assess the impact of the work of the VP/SII on the SPO. It is recommended that VP/SIs use independent studies to assess the value they provide to their SPOs, as directly questioning investees may be a delicate matter not always providing truthful answers.

4.6 Exit[99]

In most cases, an SPO's funding horizon will be longer than a VPO's investment horizon. Hence there will be a point in time where the relationship between SPO and VPO will end. This separation is called 'exit'. The 'exit' is the end of the relationship between the VPO and an investee organisation either after a pre-defined time, when the VPO can no longer add value or when the investment objectives have been achieved.

At the time of exit, the VPO determines how to exit (mode of exit) and whom to exit to (follow-on investors), balancing the financial and social return. The exit strategy execution determines the end of the financial relationship of the VPO with the SPO and therefore coincides with the last step of the investment process.

How the exit strategy is executed depends on:

- The type of financial instrument used – as some instruments have a fixed duration (i.e. grant) and the support is withdrawn when the exit date is reached, whereas other instruments are more flexible (i.e. equity).

- The context – as in different countries the exit process is implemented differently according to the possibilities for an investee to find new sources of funding.
The stage of development of the SPO – as different stages of development call for different exit modes (see table below).

Elements that influence the execution of the exit strategy

98. **Hehenberger, L., Harling, A.,** and **Scholten, P.,** (2015), *"A practical guide to measuring and managing impact – Second Edition"*, EVPA.
99. This section was developed based on the EVPA report on exit strategies: **Boiardi, P.,** and **Hehenberger, L.,** (2014), *"A practical guide to planning and executing an impactful exit"*, EVPA.

4.6 EXIT

Funding	Grant	Debt	Equity
Exit mode	Find matching support (follow-on grant sought)	Find matching support (follow-on grant sought)	
	Endowment creation for the investee		
	Follow-on loan sought	Follow-on loan sought	
			Buy-back, sale or hand-over of equity stake
			Strategic sale or merger of the SPO to an industrial partner
			Non-profit IPO
	Let go (self-sustainability)	Let go (self-sustainability)	Let go (self-sustainability)
			Not to sell equity → Stay on board
	Franchise	Franchise	Franchise

☑ In terms of whom to exit to there are three options:

- To find a new investor that can better support the investee, both in terms of financial and non-financial support, such as:
  - A public funder
  - A traditional grant-maker
  - A commercial investor
  - An industrial partner
  - A VPO
  - The broader public
- The SPO is self-sustaining, and can continue on its own with no additional support
- The investee is not performing and has to shut down its operations. This is a case of failure, and therefore the investment is not exited to any specific entity.

Whom to exit to	Opportunities	Risks
Public funder	Financial capacity Can replicate the model at national level Possibility to influence policy Broader mission/lookout on public welfare	Not capable of supporting long-term financial resilience Might not be engaged Short-term approach depending on electoral mandates It takes long to build relationships
Grant-making foundation	Financial capacity Social sector knowledge Able to achieve collective/systemic impact	May be less capable of supporting long-term financial resilience Might not be engaged Narrow mission

Social Impact Bond (S.I.B.) organisation	Linked to the effectiveness of social innovation	Not widespread enough
Commercial investor	Support on business model Financial capacity	Less focus on social impact
Industrial partners	Provides work and clients	May have little knowledge of social impact May be less inclined to build capacity of SPO
VPO	Highly engaged Scaling Financial capacity	Risk of misalignment of objectives (if additional investor)
The broad public (IPO)	Potential to mobilise (large amounts of) private capital for public good	Still under development / few experiences so far
Let the SPO continue on its own	Self-sustaining/independent	Not fully prepared
No exit options	Continue funding for another round, hoping that options will materialise or the investee will become self-sustaining	Cannot continue forever

Whatever the choice of whom to exit to, the decision needs to be guided by the objective of **keeping the social mission of the SPO going**, unless it has been demonstrated that the intervention of the SPO does not generate sufficient social return to justify its existence.

The assessment of the **'fit' of potential new investors** – including whether they share the same position on the social mission, their anticipated financial return, the desire for influence and the level of engagement in the investment – is an important exercise to enable the social impact to be maintained after exit.

The VPO and the SPO should discuss how much responsibility is placed on the investor to help the investee find follow-on financing versus this being the responsibility of the entrepreneurial team. Additionally, the VPO needs to assess whether the social mission of the investee can create tangible value (mission lock-in) such that the acquirer is de-incentivised from discontinuing the investee's social mission.

4.6 EXIT

VP/SII Industry by the numbers: from The EVPA Survey 2013/2014[100]

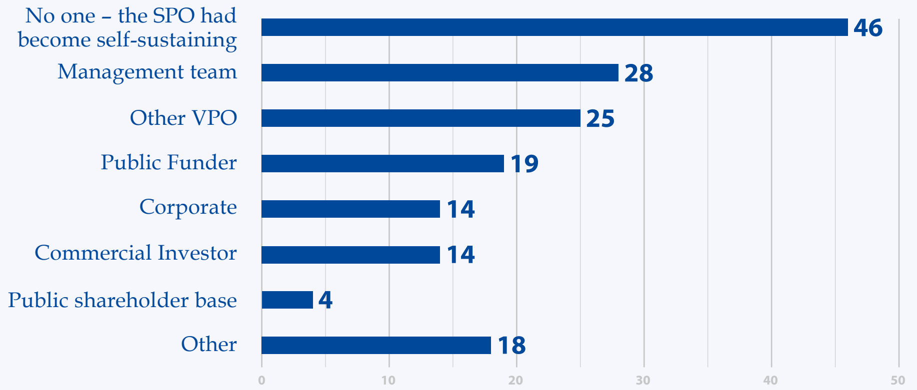


Figure 41:
To whom have VP/SII organisations exited?

n=57
multiple choice
numbers in %

Source: EVPA Industry Survey 2013/2014

Almost half of the VPOs (46%) have exited SPOs that were self-sustaining, while 28% have exited to the management team of the SPO. These results are encouraging, as VP/SII works to build stronger organisations that are capable to become self-sustaining and scale. One-quarter of the exited investments were passed on to another VPO, while almost one-fifth were taken over by a public funder. Corporate and commercial investors are an upcoming option to exit to, representing 14% of the exits each. Only 4% of the investments were exited to a public shareholder base, pointing to a lot of untapped potential for this exit option.

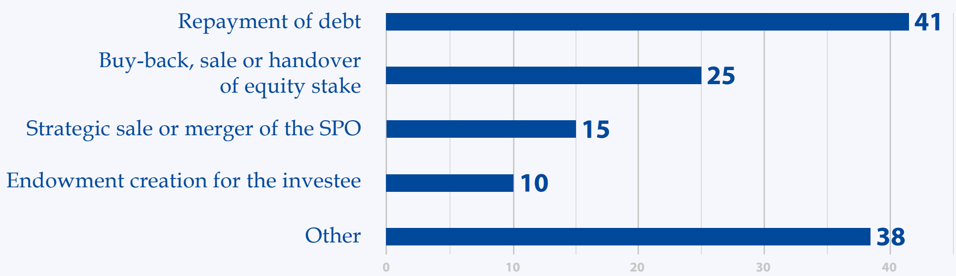


Figure 42:
How have VP/SII organisations exited their investments?

n=61
multiple choice
numbers in %

Source: EVPA Industry Survey 2013/2014

The mode of exit depends on the financing instrument used by the VPO. In the case of a grant-funded investment, the exit is a discontinuation of a grant, whereas for social impact investment the exit may involve repayment of a loan, or divestment of an equity stake. In any case, 41% of the investments were exited through debt repayment, and 25% through a buy-back, sale or handover of equity stake. Strategic sales accounted for 15% of the total exits and the creation of an endowment for the investee accounted for 10% of total exit.

100. **Hehenberger, L., Boiardi, P.,** and **Gianoncelli, A.,** (2014), *"European Venture Philanthropy and Social Investment 2013/2014 – The EVPA Survey"*, EVPA

4.7 Evaluation and post-exit follow-up

4.7.1 Evaluation

Post-exit, there will also be an evaluation of the investment (degree of achievement of investor's and investee's objectives and learnings from the process), and potentially a post-investment follow-up.

The VPO evaluates the success of the project after exit in terms of financial return and social return and the SPO determines how well it has achieved its objectives along the three dimensions of social impact, financial sustainability and organisational resilience. Importantly, the VPO should also evaluate how well it has succeeded in supporting the SPO to achieve its objectives.

In terms of social return, a VPO should aim to measure the outcomes of the investment against initial objectives. The outcomes should be verified, so that the resulting information can be used by the VP/SII itself to assess its success as a 'high-engagement' investor and take away learnings for future investments. It will also be used to report back to donors and investors on the 'social return' on their investment. The impact of the SPO itself may also be a selling argument when 'handing over the baton' to future social impact investors.

To understand the value of the non-financial support it provides, the VPO should measure how the investee perceives the value of the non-financial support it has been provided with, periodically, or at least at the end of the investment period. Ideally, this assessment is made through a survey conducted by an external, independent third party. We also recommend that the VPO makes an assessment of how well the SPO has reached the objectives defined at the beginning of the investment – although it is difficult to assign the attribution of the VPO's support to those achievements (or lack thereof). The learnings of the final impact assessment will inform the future non-financial support cycles, as they generate lessons learned as to what type of support investees value most. With sufficient data, the VPO should be able to discern patterns showing what types of non-financial support offered, as well as by whom and how, are generating the best outcomes for SPOs' development.[101]

4.7.2 Follow-up activities

The follow-up refers to all those activities that the VPO puts in place to keep a link with the SPO after exit (offering additional non-financial support, networking, etc.) to keep contact with the SPO with the purpose of both monitoring and supporting the achievement of the social impact goals after the exit. Post-exit monitoring and support can be another way to try to reduce the risk of mission drift and check that the follow-on investor is continuing the original/intended social mission/impact.

Follow-up activities are optional and the extent to which they are performed depends on the strategy of the VPO and the willingness and incentives of the SPO to stay in touch.

101. **Boiardi, P.,** and **Hehenberger, L.,** (2015), *"A practical guide to adding value through non-financial support"*, EVPA.

4.7 EVALUATION AND POST-EXIT FOLLOW-UP

VP/SII Industry by the numbers: from The EVPA Survey 2013/2014[102]

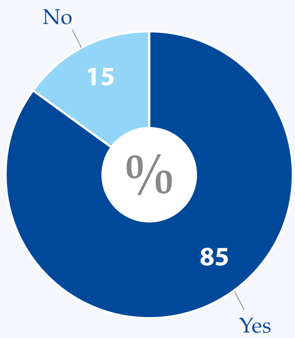


Figure 43:
% of VPOs that keep contact with the former investees

n=60

Source: EVPA Industry Survey 2013/2014

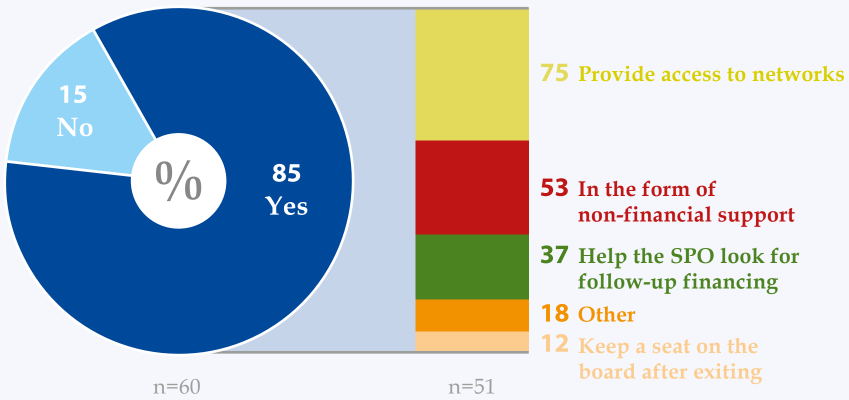


Figure 44:
Modes through which VPOs keep in contact with the SPOs post-exit

multiple choice
numbers in %

Source: EVPA Industry Survey 2013/2014

The vast majority (85%) of the VPOs that keep contact with the former investee stated that they provide access to networks to the former investees, 53% continue providing non-financial support and 37% help the investee look for follow-on financing.

102. **Hehenberger, L., Boiardi, P.,** and **Gianoncelli, A.**, (2014), *"European Venture Philanthropy and Social Investment 2013/2014 – The EVPA Survey"*, EVPA.

4.7 EVALUATION AND POST-EXIT FOLLOW-UP

case study

Case Study: PhiTrust Partenaires – Alter-Eco[103]

PhiTrust Partenaires is a social impact investment fund dedicated to providing hybrid support to economically viable, for-profit businesses in sectors that promote positive social impact and sustainable development, in Europe and globally.

In 2006, PhiTrust became involved with Alter-Eco via a pure equity investment of €528,000 (€442,000 in 2006, 5.6% share, and €86,000 in 2009, an additional 1.8% share), with a member of PhiTrust's Investment Committee actively participating in – and indeed chairing, during the exit process – the company's executive board. Alter-Eco is a company that imports a variety of products from small producers, paying them above-market rates for their work, including 30–50% upfront, and distributing their products through large retailers in developed countries. Products are packaged under a well-known brand name that is integrated in the market economy and recognised for its high-quality, fair trade products.

The table below provides an overview of the five steps of the exit strategy process applied to the exit case of PhiTrust Partenaires from its investee Alter-Eco:

Elements of the exit strategy process	PhiTrust Partenaires – Alter-Eco case
STEP 1 **Key exit considerations**	Given PhiTrust's investment strategy, the following exit strategy considerations have been identified: - Social return and financial return are equally important for PhiTrust. This implies that exit will be considered successful when both social and financial return goals are met. Exit readiness will most often be achieved when the investee has achieved its goals in terms of social impact, financial sustainability and organisational resilience. - PhiTrust envisions exits of the equity portfolio to occur at a point in time that is mutually agreed upon between the Investment Committee of PhiTrust and the entrepreneurial management team of the SPO. When using debt, the exit plan is kept flexible and the investment is monitored closely throughout the period to be able to quickly address the issues when they arise. - PhiTrust needs to manage the exit process together with the co-investors, align the exit strategy and the exit strategy process with them and be prepared to look for new co-investors at the exit date of current co-investors.
STEP 2 **Developing the exit plan**	PhiTrust began addressing the idea of an exit prior to any actual investment in Alter-Eco, during the due diligence phase. PhiTrust wanted to ensure that the investee understood that while PhiTrust had a long-term investment and mentoring horizon, the exit remained a certainty. When the deal was being structured, PhiTrust worked with the Alter-Eco entrepreneur to define the exit plan. The SPO was asked to report (either annually or every six months) on measurable impact criteria, directly related to the social mission of the organisation. The company's activities were linked to measurable results that led to the expected long-term effects as shown in the figure:

103. **Boiardi, P.,** and **Hehenberger, L.,** (2014), *"A practical guide to planning and executing an impactful exit"*, EVPA.

4.7 EVALUATION AND POST-EXIT FOLLOW-UP

<table>
<tr>
<td>STEP 2
Developing the exit plan</td>
<td>
<table>
<tr><th>Ideas, Contribution</th><th>Activities</th><th>Results</th><th>Long-term effects</th></tr>
<tr>
<td>• Improve the income of fair trade and organic food producers in countries in both the South and the North</td>
<td>• Prefinance purchases directly from producer cooperatives
• Support and monitor cooperatives
• Develop and market a range of Alter-Eco branded products in supermarkets across Western Europe and North America</td>
<td>• Ensuring regular income for producers at above market prices
• Development of activities to transform products in developing countries
• Re-structuring cooperatives to ensure their sustainability</td>
<td>• Poverty reduction in rural areas
• Preservation of agricultural family model
• Raising awareness about socially responsible consumption</td>
</tr>
</table>
The exit plan was revised regularly with Alter-Eco management team, on a formal and informal basis.
</td>
</tr>
<tr>
<td>STEP 3
Determining exit readiness</td>
<td>PhiTrust Partenaires' 2012 Annual Report indicates that while Alter-Eco was meeting its sales goals and social return expectations, PhiTrust felt that the company's financial growth and overall development were not progressing as quickly as had hoped, in large part due to headwinds in the fair trade market in France.

Faced with the fact that several equity investors in Alter-Eco were reaching fund maturity and would soon need to sell their shares, and given the stagnant demand for fair trade products in France, it became increasingly clear in 2011 that new investors were needed to provide the capital necessary to open up new markets for the company. Thus began a two-year process of discussions with potential follow-on investors (led by the executive board, chaired by a member of PhiTrust's Investment Committee). PhiTrust Partenaires had decided that the market context and the need for an influx of new capital meant that its value-add to the SPO was increasingly diminished, and that a strategic exit to an appropriate follow-on investor would be the most beneficial decision for both PhiTrust and Alter-Eco.</td>
</tr>
<tr>
<td>STEP 4
Executing the exit</td>
<td>In late May 2013, subsequent to several rounds of negotiations with potential follow-on investors, PhiTrust's shares (and indeed all shares of Alter-Eco) were sold to Wessanen Distriborg, a European leader in the sale of organic food products. Those who exited felt strongly that this additional support was necessary to enable Alter-Eco to continue developing in an increasingly difficult fair trade and organic food market. The buyer offered to maintain the existing business model (allowing small producers in developing countries to access Western European customers) in addition to providing access to other European markets, particularly in Northern Europe.

To PhiTrust, it was crucial that the follow-on investor would ensure the continued growth of the company, both from a financial and impact perspective. For this reason, it prioritised the sale of its shares to a company that would maintain the existing business model, rather than one which would have prioritised a financial strategy but potentially re-oriented the company's social activities towards more commercially beneficial operations. This exit strategy was a clear mandate from the Investment Committee, and was the lens through which Alter-Eco approached each potential new investor.</td>
</tr>
<tr>
<td>STEP 5
Post-investment follow-up</td>
<td>When evaluating the achievement of its own social impact and financial return goals, PhiTrust can consider the investment to have been successful. PhiTrust exited a strong company, importing from a large number of high-quality producers paid above market rates. From a financial return perspective, the transaction price retained was that of the balance sheet valuation of Alter-Eco as of 31 December 2012.</td>
</tr>
</table>

4.7 EVALUATION AND POST-EXIT FOLLOW-UP

STEP 5

Post-investment follow-up

Dimension	Results
Social impact	Working with 42 small holder farmers in South & Central America, Africa and Asia Farmers paid 51% above market rates >8,000 tonnes of CO_2 offset annually
Financial sustainability	€17.7 million in annual sales in 2012 (+84% since 2005)
Organisational resilience	Poised to continue expanding in new markets, be they in other European countries or internationally Leadership team was competent, visionary and continued to suggest and implement innovative ideas

When evaluating the achievement of its own social impact and financial return goals, PhiTrust can consider the investment to have been successful. PhiTrust exited a strong company, importing from a large number of high-quality producers paid above market rates. From a financial return perspective, the transaction price retained was that of the balance sheet valuation of Alter Eco as of 31 December 2012.

Key Issues and Learnings

- **Deal flow** – Getting the right volume and quality of deal flow is critical. Therefore, most funds take a proactive approach to identifying and engaging with target SPOs, rather than establishing an open application process.
- **Deal Screening and Due Diligence** – While the precise process varies from organisation to organisation, most employ multiple screens. Final investments are usually made on the basis of the SPO's business plan and match between (i) the social impact objectives of the SPO and the social impact and financial return objectives of the VPO and (ii) the needs of the SPO and the offer of the VPO in terms of non-financial support.
- **Investment Decision and Deal Structuring** – The VPO shall choose to support SPOs that have alignment in terms of objectives and that can benefit from the financial and non-financial support the VPO can offer. The deal structuring is a planning phase, during which the VPO and SPO develop the non-financial support plan, the exit plan and set the objectives for the SPO in terms of social impact and its measurement.
- **Investment management** – During the investment phase, the VPO will be actively engaged with investee SPOs on an ongoing basis. This engagement can take many forms but it should be agreed on beforehand. The VPO monitors the investment by means of the plans agreed in the deal structuring, takes corrective actions if and where needed, and assesses when exit readiness is achieved.
- **Exit** – At the time of exit the VPO will decide whom to exit to and the mode of exit. These will largely depend on the type of financial instrument used, the context and the stage of development of the SPO. The VPO is guided in its decision by the aim of keeping the social impact of the SPO going even after exit.

Part 5:

Reflections on the journey so far

REFLECTIONS ON THE JOURNEY SO FAR

Venture Philanthropy is a relatively new addition to the philanthropy toolkit. Although in Europe the industry is just over ten years old, the VP approach is today considered one of the key tools of organisational philanthropy in Europe, with its own practices that are increasingly normalised and shared. European VPOs have been able to 'bend' USA models to match their own political and cultural contexts, ranging from Western European welfare states to emerging markets in Central and Eastern Europe, where the approach is spreading.

In the first edition of 2008, we documented how VP itself was an innovation emerging from both the philanthropic and investment worlds/markets, and the founding players in Europe were innovating through applying investment principles to investees in order to support them to make a step change in their impact. The nature of the innovation was the development and testing of VP tools and approaches in different political economic and cultural contexts across Europe and also in the developing world. The second edition in 2010 showed how the VP approach emerged as a way to tackle social sector challenges in an environment strongly hit by reducing Government budgets also due to the financial crisis and how VP broadened the set of financial instruments used, catalysing a social impact investment movement which complemented and built on the use of grants in the initial VP movement.

In this edition we focus on the learnings of the past five years, providing guidance to organisations that want to start investing using the VP approach of what works and what does not and helping established organisation refine their approach to achieve even greater societal impact.

What are the upcoming challenges for the sector?

Social impact investment funds are starting to raise bigger funds than before, thanks to the positive track record with their first funds, but also with the increased access to institutional and public funding channeled through by funds of funds such as Big Society Capital in the UK, and the European Investment Fund's Social Impact Accelerator. Bigger funds will allow the social impact investment fund managers to hire more people and pay them more competitively, but it will also mean that most likely they need to target higher financial returns. Such a pressure on financial returns may force fund managers to take less risk and invest in more mature social enterprises, leaving the early-stage entities under-funded.

It is clear that the global impact ecosystem needs to evolve further to cover all stages in the evolution of both non-profit organisations and commercial social enterprises. Some countries are more advanced than others, but in general we need incubators, angel investors and grant-makers at early stages, social impact investors at more mature and growth stages, and corporates and public funders to provide more resource-heavy investments to scale up massively. The European Commission's Expert Group on Social Business (GECES) has just launched a working group on "improving access to funding of social enterprises"

REFLECTIONS ON THE JOURNEY SO FAR

that is developing recommendations on how to encourage and enable an ecosystem to provide access to funding for social enterprises within Europe.

The role of venture philanthropy in the social impact ecosystem is to enable a step change towards achieving systemic impact, by bringing solutions and organisations to a more sustainable and scalable level. In essence, by applying the VP model, the funder should enable the investee organisation to move from one level to the next (e.g. from start-up to growth), by becoming more sustainable and scalable, on its trajectory towards achieving systemic change. Venture philanthropy can as such be seen as an approach that is applicable by funders interested in achieving societal impact, whether they are interested in a financial return or not.

How can we encourage more funders – private and public – to use venture philanthropy? The next big challenge for the sector is to demonstrate the value-add of venture philanthropy. The high-engagement nature of venture philanthropy makes it more costly than traditional philanthropy and arm's-length financial investments. For the sector, the current lack of evidence makes it difficult to make a strong case both to new actors to implement the (costly) VP model, and for private and public funders to provide necessary resources for VPOs to operate at large scale.

With that purpose, EVPA and its Asian sister organisation, the Asian Venture Philanthropy Network (AVPN), are launching a research project that aims to provide VPOs with concrete data to be able to assess their impact on their investees and revise their strategy to improve their intervention model if necessary. Therefore, the overall impact of the VPO's work should also be accelerated by generating a learning and data-driven culture. Furthermore, EVPA and AVPN would be able to more clearly show how and how much the VP sector impacts on SPOs. If successful, we believe that this information will have beneficial consequences in terms of fundraising and resource inflows to the sector.

We look forward to the next stage of innovation and learning in venture philanthropy and social impact investment, to sharing that learning, and to contributing to the emerging global debates on impact and practice. Lastly, we must remain humble as we remind ourselves of why we do this work together, to improve the world we live in.

Appendices

APPENDICES

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List of interviewees (alphabetical order):

- **Luciano Balbo**, Founder and President, *Oltre Venture*.
- **Emilie Goodall**, Director of Projects, *Bridges Ventures*.
- **Deirdre Mortell**, CEO, *Social Innovation Fund Ireland*.
- **Pieter Oostlander**, Fund manager, *SI2 fund*.
- **Chloé Tuot**, Social Investment Manager, *PhiTrust*.

APPENDICES

Glossary of Terms

Attribution
Attribution takes account of how much of the change that has been observed is the result of the organisation's activities, and how much is the result of actions taken simultaneously by others (e.g. other SPOs, government).

Baseline
The baseline is the initial collection of data that describes the state of development of the SPO when the VPO starts investing in it. The baseline serves as a basis for comparison with the subsequently acquired data on the development of the SPO.

Beneficiaries
The people, communities, broader society and environment that an SPO seeks to reach through its activities. Beneficiaries can be affected positively or negatively by the activities of the SPO.

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

Organisational development
Added value support services that VPOs offer to investees (SPOs) to strengthen the SPO's organisational resilience and financial sustainability by developing skills or improving structures and processes.

Co-investment (also known as 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 an SPO, by other funders (e.g. grant-makers or individuals) alongside a venture philanthropy organisation.

Deal flow
Deal flow refers to the number and/or rate of new proposals presented to the investor. This term is used with respect to venture capital/private equity funds, venture philanthropy funds, and has also been borrowed and used by philanthropists in reference to 'deals' or potential projects to be awarded grants.

Debt financing (also see Loan financing)
Debt financing is borrowed money used to finance a business, either traditional or 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.

Deliverable
A deliverable is a tangible or intangible object produced as a result of the project that is intended to be delivered to a customer (either internal or external). A deliverable could be a report, a document, a server upgrade or any other building block of an overall project.

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

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.

APPENDICES

Exit
An exit strategy is the action plan to determine when the VPO can no longer add value to the investee, and to end the relationship in such a way that the social impact is either maintained or amplified, or that the potential loss of social impact is minimised

Financial sustainability
The assessment that an SPO will have sufficient resources to continue pursuing its social mission, whether they come from other funders or from own revenue-generating activities.

Foundation
Public-benefit foundations are asset-based and purpose-driven. They have no members or shareholders and are separately constituted non-profit 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 VP, foundations are non-profit organisations that support charitable activities either through grant-making or by operating programmes. (Source: http://www.efc.be/philanthropy-sector/faq)

Fund
A fund is a vehicle created to enable pooled investment by a number of investors and which is usually managed by a dedicated organisation.

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 VPOs and grant-makers 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 levels, a portion of the grant may be returned.

Grant-maker
Grant-makers include institutions, public charities, private foundations, and giving circles, which award monetary aid 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.

Guarantee
A guarantee is a promise by one party (the guarantor) to assume the debt obligation of a borrower if that borrower defaults. A guarantee can be limited or unlimited, making the guarantor liable for only a portion or all of the debt. In the VP context, guarantees are one of the financial instruments available for VPOs to support SPOs. The VPO in this case does not need to supply cash upfront, but it opens up access to bank funding by taking on some or all of the risk that the lender would otherwise incur. (Source: https://en.wikipedia.org/wiki/Loan_guarantee)

High-engagement partnership
Creating hands-on relationships between the supported organisation's management and the VPO. This practice foresees VP taking board seats in the organisations they invest in or give a grant to and/or to frequently meet with investees' management.

Impact
See: *Social Impact*

Impact Investment
See: *Social Impact Investment*

Impact Investor
See: *Social Impact Investor*

Impact Measurement
Measuring and managing the process of creating social impact in order to maximise and optimise it.

Indicators
Indicators are specific and measurable actions or conditions that assess progress towards or away from outputs or outcomes. Indicators may relate to direct quantities (e.g.

number of hours of training provided) or to qualitative aspects (e.g. levels of beneficiary confidence).

In-house resources

Resources provided within the VPO itself, through its staff members or volunteers, as opposed to people within the greater network of the venture philanthropists, service providers, or portfolio organisations.

Investee

The social purpose organisation that is the target of VPO activity and the recipient of financial and non-financial support.

Investment

We use investment throughout this document as including the range of financing instruments from grants, loans to equity.

Investment manager

See: Portfolio manager

Investment proposal

The investment proposal is the document prepared by the VPO to present a potential investment (including nature, goals and funding) to the investment committee.

Key performance indicators (KPIs)

Key Performance Indicators (KPIs) are a business metric used to evaluate the extent to which the organisation has achieved a goal and factors that are crucial to the success of an organisation. KPIs differ per organisation, business KPIs may be net revenue or a customer loyalty metric, while government might consider unemployment rates.

Loan financing

See: *Debt financing*

Long-term investment

A long-term investment is made over a period of five years or more.

Mezzanine financing

Mezzanine financing is a hybrid of debt and equity financing, usually used to fund the expansion stage or an organisation. Although it is similar to debt capital, it is normally treated like equity on the organisation's balance sheet. Mezzanine finance involves the provision of a high-risk loan, repayment of which depends on the financial success of the SPO. This instrument bridges the gap between debt and equity/grant though some form of revenue participation. Examples include a loan that is only repayable through royalties based on the future sales of a product or service; or a royalty-sharing agreement that can be activated once an agreed profitability threshold has been reached. These instruments can offer an appropriate balance of risk and return.

Non-financial support

The support services VPOs offer to investees (SPOs) to increase their societal impact, organisational resilience and financial sustainability, i.e. the three core areas of development of the SPO.

Organisation

For the purpose of this report the term includes SPOs and VPOs.

Organisational resilience

The assessment of the degree of maturity of an SPO, in terms of the degree of development of the management team and organisation (governance, fund raising capacity etc.).

Outcomes

The changes, benefits, learnings, or other effects (both long and short term) that result from the organisation's activities.

Outputs

The tangible products and services that result from the organisation's activities.

Portfolio

A portfolio is a collection of projects and/or organisations that have received sponsorship from the investor. A distinction is often made between 'active' and 'past' portfolio,

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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 (see also Investment manager)
A portfolio manager is given the responsibility of tracking the performance of and maintaining communications with the various organisations and/or projects within the investor's portfolio.

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.

Pro-bono contribution
Professional work undertaken voluntarily and without payment. Unlike traditional/unskilled volunteerism, it is service that uses the specific skills of professionals to provide services to those who are unable to afford them.

Pro-bono contributor
A professional who provides specific skilled support to an organisation without the payment of a fee.

Quasi-equity financing
See: *Mezzanine financing*

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.

Scaling up
Processes of developing and growing the activities of an SPO to expand its social reach and increase its social impact.

Short-term investment
A short-term investment is made over a one-year period less, or an investment that matures in one year or less.

Social sector
Social sector is an alternative term used in reference to the non-profit sector, non-governmental sector, voluntary sector, independent sector, or third sector.

Social enterprise
Social enterprise is an organisation that focuses on achieving social impact, applying market-based solutions to address public sector and market failure in innovative ways. Social enterprise can take on a variety of legal forms. (Source: Maretich, M., and Bolton, M., (2010), "Social enterprise: From definitions to developments in practice", EVPA.)

Social entrepreneur
Social entrepreneur is defined by the Schwab Foundation as "a leader or pragmatic visionary who:

- Achieves large scale, systemic and sustainable social change through a new invention, a different approach, a more rigorous application of known technologies or strategies, or a combination of these.
- Focuses first and foremost on the social and/or ecological value creation and tries to optimize the financial value creation.
- Innovates by finding a new product, a new service, or a new approach to a social problem.
- Continuously refines and adapts approach in response to feedback."

(Source: http://www.schwabfound.org/content/what-social-entrepreneur)

Social impact
The attribution of an organisation's activities to broader and longer-term outcomes. To accurately (in academic terms) calculate social impact you need to adjust outcomes for: (i) what would have happened anyway ('deadweight'); (ii) the action of others ('attribution'); (iii) how far the outcome of the initial intervention is likely to be reduced over time ('drop off'); (iv) the extent to which the original situation was displaced elsewhere or outcomes displaced other potential positive outcomes ('displacement'); and for unintended consequences (which could be negative or positive).

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Social impact investment (SII)
Social Impact Investments are those that intentionally target specific social objectives along with a financial return and measure the achievement of both. (Source: http://www.socialimpactinvestment.org/reports/Impact%20Investment%20Report%20FINAL[3].pdf)

Social impact investment
Social impact investment is the provision and use of capital to generate social as well as financial returns. The social impact investment approach has many overlaps with the key characteristics of venture philanthropy, however social impact investment means investment mainly to generate social impact, but with the expectation of some financial return (or preservation of capital).

Social impact investor
An organisation pursuing a social impact investment approach.

Social Purpose Organisation (SPO)
An organisation that operates with the primary aim of achieving measurable social and environmental impact. Social purpose organisations include charities, non-profit organisations and social enterprises.

Theory of change
A theory of change defines all building blocks required to bring about a given long-term goal. This set of connected building blocks is depicted on a map known as a pathway of change or change framework, which is a graphic representation of the change process.

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

Venture philanthropy (VP)
VP is a high-engagement and long-term approach to generating societal impact through three practices:

- **Tailored financing:** Using a range of financing mechanisms (including grants, debt, equity hybrid financing) tailored to needs of organisation supported.
- **Organisational Support:** Added-value support services that VPOs offer to investees (SPOs) to strengthen the SPO's organisational resilience and financial sustainability by developing skills or improving structures and processes.
- **Impact measurement and management:** Measuring and managing the process of creating social impact in order to maximise and optimise it.

Venture Philanthropy Organisation (VPO)
Organisations following the venture philanthropy approach. A Foundation can be a VPO.

Volunteer
A person who voluntarily offers himself or herself to performs a service willingly and without pay. For the purpose of this report, differently from pro-bono and low-bono supporters, volunteers offer unskilled labour.

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The European Venture Philanthropy Association (EVPA)

Established in 2004, EVPA works to enable Venture Philanthropists and Social Investors to maximise societal impact through increased resources, collaboration and expertise.

EVPA's membership covers the full range of venture philanthropy and social impact investment activities and includes venture philanthropy funds, social investors, grant-making foundations, impact investing funds, private equity firms and professional service firms, philanthropy advisors, banks and business schools. EVPA members work together across sectors in order to promote and shape the future of venture philanthropy and social impact investment in Europe and beyond. Currently, the association has 214 members from 29 countries, mainly based in Europe, but also outside Europe showing the sector is rapidly evolving across borders.

EVPA is committed to support its members in their work by providing networking opportunities and facilitating learning. Furthermore, we aim to strengthen our role as a thought leader in order to build a deeper understanding of the sector, promote the appropriate use of venture philanthropy and social impact investment and inspire guidelines and regulations.

http://www.evpa.eu.com

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