Report on Financial Instruments Used to Provide Public Services in Germany

RECOMMENTDATIONS FOR A SUCCESSFUL MODEL TO BE LAUNCHED IN POLAND

Dr. Markus Freiburg & Christina Moehrle

Financing Agency for Social Entrepreneurship (FASE)

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ABOUT FASE AND THE AUTHORS

Dr. Markus Freiburg is co-founder and managing director of the Financing Agency for Social Entrepreneurship (FASE). FASE's mission is to assist social enterprises with outstanding concepts in raising hybrid growth capital. In more than three years since FASE's inception, Markus and his professional team have helped more than 30 leading social enterprises in Germany and Austria to identify appropriate financing instruments and suitable investors so that they can grow their businesses and increase their impact. With the support of FASE, social enterprises become empowered to finance significant growth steps across the often rigid boundaries between donors, investors and the public sector. Investors interested in impact, on the other hand, benefit from a pipeline of investment-ready social enterprises fueled by FASE, which – in combination with novel hybrid financing instruments developed by FASE – contributes to the emergence of a thriving ecosystem for early-stage social finance in Germany.

In the meantime, Markus is recognized as a thought leader for social finance across Europe. He has an active presence in public discourses, e.g. as a member of the Expert Group on Social Entrepreneurship (GECES) of the EU Commission, of the German National Advisory Board of the G7 Social Impact Investing Taskforce, and of the EVPA expert group on hybrid finance. He also (co-)authored multiple articles, reports and case studies on best practices in social enterprise finance. Prior to FASE, Markus worked as top-management consultant for McKinsey & Company and gained relevant experience as pro-bono consultant for social entrepreneurs. He studied Business Administration and Economics at the University of Witten/Herdecke (Diplom-Ökonom) as well as European Studies at the University of Cambridge (M.Phil.), and received his Ph.D. from the WHU - Otto Beisheim School of Management (Dr. rer. pol.). More about FASE: www.fa-se.de/en

Christina Moehrle entered the social finance sector in 2011 and started her own shop as a freelance writer and journalist to specifically promote social entrepreneurship, social finance and impact investing. Since mid-2014, she also takes care of FASE's communications, media and publications. After 15 years in the finance industry, most recently as a partner and investor relations manager with an international venture capital firm as well as a director for structured finance at Deutsche Bank Trust AG, helping to build the social finance ecosystem has become Christina's passion and profession.

In the past 6 years, Christina (co-)authored more than 60 articles, blogs, interviews, case studies and papers on various aspects of social finance, working for print and online media as well as for clients such as Roots of Impact, Bertelsmann Foundation and Ananda Ventures. She is also engaged in impact finance education and co-designed the online course "access to impact investment for social entrepreneurs", which was launched in May 2017 by the Social Finance Academy and VIVA Idea. Christina holds a Master's degree in Business Administration from the University of Mannheim, Germany, and is member of the German journalist association DFJV (Deutscher Fachjournalistenverband).

EXECUTIVE SUMMARY

The environment for impact investments in the German market has significantly improved over the last years. The situation also applies to a specific segment within the impact investing sphere: social enterprises. These double bottom line actors are important drivers of change that operate based on viable business models and fill a very important role in the market: as providers and agents of innovation, prevention and efficiency, situated between the public and the private sectors. For these "agents of innovation", however, poor access to finance is still perceived as one of the most significant barriers to success, especially if social enterprises are in early stages of their lifecycles.

Therefore, one of the most important roles of the Financing Agency for Social Entrepreneurship (FASE) is to design suitable building blocks that are capable of overcoming the "strategic financing gap" that early-stage social enterprises are facing today. To remove barriers, private sector initiatives need to be catalyzed and market actors coordinated. At the same time, hybrid financing models are able to efficiently bridge the gaps between the needs of financiers and those of social enterprises.

This paper outlines five specific hybrid financing models developed by FASE that proved to be very successful in practice when crowding in growth capital for social enterprises from various types of investors:

- Model 1: Mezzanine capital with revenue participation and social impact incentive,
- Model 2: mezzanine capital with profit participation and social impact incentive,
- Model 3: equity donation combined with impact investment,
- Model 4: crowd investment combined with impact investment,
- Model 5: hybrid early-stage co-investment fund.

In addition, pay-for-results models are compelling solutions to address another important building block for the social finance ecosystem: internalizing externalities by monetizing positive social contributions created by social enterprises. Here, Social Impact Bond (SIB) structures as well as more direct solutions such as Social Impact Incentives (SIINC) are able to pre-finance and test innovative and more efficient solutions to social challenges and therefore have the potential to create substantial savings for the public sector.

With a wealth of experiences, tested models and successful case studies gained in Germany, this paper provides three key recommendations for a successful replication of best practices in other European countries such as Poland:

- Providing sufficient growth capital to early-stage social enterprises
- Supporting the build-up of the ecosystem for social enterprise finance
- Replicating the FASE model in Poland

1. THE GERMAN MARKET FOR SOCIAL FINANCE

The social finance market in Germany is experiencing a slow but steady evolution. The environment for impact investment has "strongly benefited from increased attention as well as from national and international initiatives to build the market" – as a study by Bertelsmann Foundation on the German market concluded in 2016[1]. Estimated assets investible for impact have almost tripled to EUR 70 million within three years, which translates into new allocations of approximately EUR 7 to 8 Mn. annually. Such positive trend, however, is largely due to a relatively small number of pioneers, e.g. two social venture capital funds (BonVenture and Ananda Ventures), several foundations (e.g. the combined BMW and Eberhard von Kuenheim Foundations, Bertelsmann Foundation) and FASE as a specialized intermediary for early-stage social finance.

The current situation predominantly applies to a specific segment within the impact investing sphere: social enterprises. These double bottom line actors are important drivers of change that operate based on viable business models and fill a very important role in the market: as providers and agents of innovation, prevention and efficiency[2], situated between the public and the private sectors. Social enterprises develop innovative approaches, models or practices for resolving societal challenges in an entrepreneurial way. Thus, they actively support a paradigm shift that prioritizes inclusive, socially fair and environmentally sustainable economic development and social change – a role that is vital for reaching the Europe 2020 targets [3] and implementing the Sustainable Development Goals and the Paris climate accord.

For these "agents of innovation", however, poor access to finance is still perceived as one of the most significant barriers to success. The "Social Business Initiative" launched by the European Commission[4] in 2011 emphasized that the funding system for social enterprises is underdeveloped in relation to that available to traditional businesses. Several pan-European and national studies confirmed these imperfections in the social finance market[5]. In addition, existent market actors do not seem to cooperate very well. Different

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

[2] NAB Germany: „Social Impact Investing: Financing Social Change", final report, 2014, https://www.bertelsmann-stiftung.de/de/publikationen/publikation/did/social-impact-investing-financing-social-change/

[3] See http://ec.europa.eu/europe2020/targets/eu-targets/index_en.htm

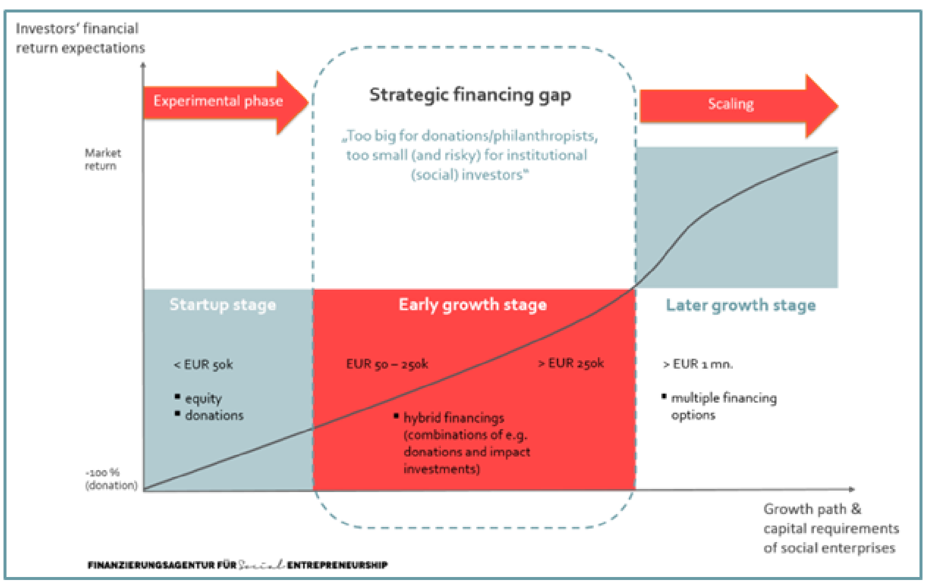
[4] Communication from the Commission to the EP, the Council, the EESC and the CoR: "Social Business Initiative - Creating a favorable climate for social enterprises, key stakeholders in the social economy and innovation" http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2011:0682:FIN

[5] For example: Wolfgang Spiess-Knafl, Stephan A. Jansen: „Imperfections in the social investment market and options on how to address them", an ecosystem report on behalf of the European

suppliers of financing usually apply a broad range of mostly incoherent and unrelated eligibility criteria, return expectations, conditions for repayment, and requirements for accounting as well as reporting. This phenomenon often leaves social enterprises lost between different "financing planets"[6] and prevents them from scaling their impact.

Social enterprises also face substantial difficulties when trying to develop an efficient mix of funding sources. In particular, this bottleneck is prevalent in the critical segment of smaller deals (<250,000 EUR) and risky development activities, for which risk sharing is essential and hard to find. Consequently, there is a strong need for market facilitators and hybrid financing models that enable cooperation between investors, donors and public authorities. The situation is even worse for social enterprises in early stages of their lifecycles: Here, financing amounts of EUR 100,000 to 500,000 are typically necessary to scale. Most of these social enterprises, however, are not able to cover more than 75% of their operating costs with revenues (yet).

At the same time, the majority of today's impact investors is waiting at the very end of the investment pipeline: They expect mature investees who have proven their models in the market and reached break-even. Thus, early-stage social enterprises often find themselves on the edge of a precipice: a "strategic financing gap" where the required amounts of funding tend to be too big for donations or philanthropist and too small and risky for institutional social investors.



Graph 1: "The strategic financing gap" (Source: FASE)

Commission, 2013, https://www.zu.de/info-wAssets/forschung/dokumente/cisoc/Final-Report-Imperfections-in-the-Social-Investment-Market-ZU-vfinal.pdf

[6] Ashoka: „From Solar System to Ecosystem: A New Way to Finance Social Entrepreneurs" on Forbes, https://www.forbes.com/sites/ashoka/2012/07/02/from-solar-system-to-ecosystem-a-new-way-to-finance-social-entrepreneurs/#7a7a5ab93af8

The German social finance ecosystem is therefore still in a relatively early stage. Judging by the share of impact investments as compared to the total assets available for investment, there is vast room for improvement. The ecosystem has to deal with a variety of structural challenges that are also typical for other European countries: a limited investor base, too few (or too small) specialized intermediaries, an insufficient availability of investment products, a general weakness in social enterprises' investment readiness and the need for effective advisors and supporters to build a functioning market.

At the same time, an array of activities recently led to a stronger momentum. Existing social venture funds were able to increase the sizes of their follow-on funds, several foundations finally turned to active impact investing, intermediaries such as FASE developed new financing models/investment vehicles and the market environment in general has stabilized. The German National Advisory Board of the G7 Social Impact Investment Task Force ("NAB Germany") proudly noted that the first recommendations were successfully put into practice[7].

Yet if the entire European social finance market is to thrive and develop critical mass, it is obvious that existing barriers have to be removed, private sector initiatives catalyzed and market actors coordinated. A robust and diversified landscape of investors and intermediaries can successfully channel and supply capital to social enterprises, while newly designed hybrid financing models are able to efficiently bridge the gaps that currently still prevail between the needs of financiers and those of social enterprises.

[7] NAB Germany, see footnote 2

2. DIRECT INVESTMENTS IN SOCIAL ENTERPRISES

2.1. MATCHING THE NEEDS

THE INVESTOR SIDE

Closing the gaps, in essence, "is making the abundant amounts of capital effectively match with suitable investment targets"[8] , as a study launched by McKinsey, Ashoka and FASE in 2016 concludes. Lower financial returns should be acceptable for investors as long as investments exhibit low market correlation and low interest rate correlation. This holds specifically true for a specific investor subgroup known as "impact-first impact investors": they are willing to sacrifice part of their financial returns in favor of more positive impact on society. To convince financial-first investors, however – those financiers seeking market- or near-market rates of return – to accept lower IRRs for less correlation will be much more challenging. This is a very relevant point since the subgroup accounts for approximately 80 percent of all impact investors, according to the Global Impact Investing Network (GIIN)[9].

Judging from a general hype around impact investing in recent months, the social performance dimension is, however, gaining importance. For foundations in specific, the continuing low-yield environment creates a strong incentive to start looking for alternatives to invest capital stock. Rather than emulating the restrictive investment models of most impact investors, foundations "could think of investing as recycling of donations, and develop the flexibility to ask only for partial returns"[10]. To combine grants and investments in creative ways is already at the core of FASE's activities in Germany: Developing hybrid financing models and investment vehicles to channel more capital to the social finance market also involves engaging foundations in innovative ways. This can be achieved by convincing them to become donors in FASE's "equity donation" model (see Section 2.2), or – in a more advanced vision – to act as grant makers in layered fund structures by providing loss protection for other impact investors ("catalytic first loss capital", see example in Section 2.2). One key to closing the gaps also lies in smart combinations of different types of investors that fit the specific needs and requirements of all parties involved, especially those of social enterprises. FASE built on this idea with its

[8] FASE, Ashoka, McKinsey: „Achieving Impact for Impact Investing – a road map for developed countries", 2016, http://fa-se.de/wp-content/uploads/2016/04/Ashoka-FASE-McKinsey-Achieving-Impact-for-Impact-Investing-2016.pdf
[9] Global Impact Investor Network (GIIN): "Annual Impact Investor Report 2017", 2017, https://thegiin.org/knowledge/publication/annualsurvey2017
[10] Philanthropy Impact: „Full spectrum finance - how philanthropy discovers impact beyond donation and investments" by Felix Oldenburg and Bjoern Struewer, 2016, http://philanthropy-impact.org/article/full-spectrum-finance-how-philanthropy-discovers-impact-beyond-donation-and-investments

individual "deal-by-deal approach" and has assisted many social enterprises to date in successfully raising growth capital the "hybrid" way.

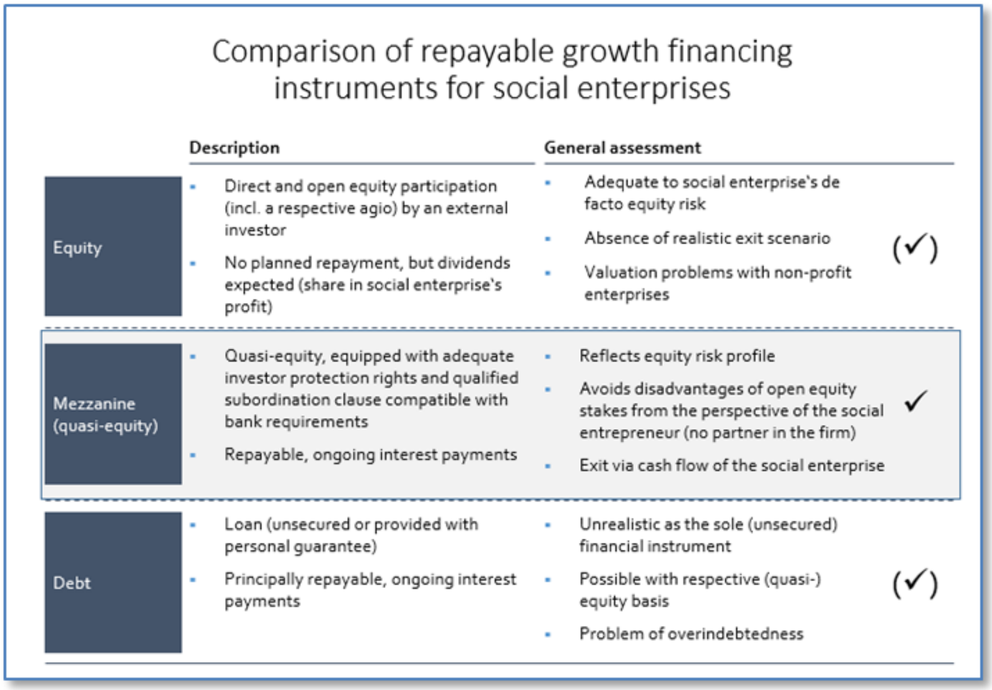
Another, equally important building block is to create incentives for social investment through so-called "pay-for-results models" (PFR). Here, either social enterprises or their investors are incentivized through payments received for verified impact. In essence, these models include and monetize positive externalities, i.e. the "fourth dimension" of social contribution that is at the core of both, social entrepreneurship and impact investing. Typically, such outcome payments are provided by philanthropic players, development banks or government bodies. If the public sector engages in such a structure, its motivation is typically to lower expenses for social services and/or test new approaches to social challenges that are pre-financed by the private sector. This is mostly the case in Social Impact Bonds, one of the most well-known PFR models (see also the German example in Section 3.2).

THE SOCIAL ENTERPRISE SIDE

When investigating the specific needs of social enterprises, it soon becomes obvious that traditional financing approaches will rarely be able to match both sides, capital demand and supply. Hybrid social finance, in this sense, is meant to disrupt the inadequate status quo of today's traditional capital markets. As opposed to commercial companies, most social enterprises, specifically in early stages, require flexible, often unsecured forms of financing that allow them to make repayments in line with available cash flows. Another common need is to preserve as much flexibility as possible with respect to future financing rounds. Also, choosing equity instruments and taking a real partner on board is often not an option, especially for social entrepreneurs with a strong concern about the preservation of their missions. With equity, there is also the problem of company valuation and suitable exit scenarios for investors via M&A or IPO (e.g. through currently rare or "illiquid" social stock exchanges and secondary markets). With debt alone, on the other hand, social enterprises can quickly become over-indebted, which stifles their ability to grow and develop their businesses as planned. In general, FASE's experience has shown that there is no such thing as a "one fits all" solution for early-stage social enterprise finance.

One approach, however, has proven to be very valuable: Quasi-equity (or "mezzanine") is capable of combining the most suitable characteristics of equity and debt. In Germany, mezzanine capital ("Genussrechtskapital") can be structured in a very flexible way, with either more equity or more debt character, depending on subordination clauses, investor rights and other features. At the same time, it can serve as "economic" quasi-equity, which increases the social entrepreneur's ability to raise additional financing and preserve existing securities. It is also flexible enough regarding repayment terms and can do without the introduction of a shareholder, who will participate in the entrepreneur's decision-making. Last but not least, social entrepreneurs and investors can link mezzanine capital payments and repayments to specific milestones that are either financial performance- and/or social impact-driven. In the case of impact incentives, the social entrepreneur will enjoy reduced financing costs once he or she fulfills the pre-agreed impact goals.

The following graph summarizes again the main arguments for and against equity, mezzanine and debt from the point of view of a social enterprise:



Graph 2: "Comparison of repayable growth financing instruments for social enterprises" (Source: FASE)

2.2. OVERVIEW OF HYBRID FINANCING INSTRUMENTS

As a result of these insights, FASE developed several hybrid financing models for direct investments in social enterprises and one hybrid fund vehicle. All of these models smartly combine the available financing instruments to meet the specific needs of the investment targets. They also serve to attract new types of investors and integrate them into one solution, even if they come from very different "financing planets". In the following paragraphs, five different hybrid financing models shall be explained in more detail. The first three models feature tailored financing solutions that can be applied to social enterprises with not-for-profit and for-profit organizational entities (called "structural hybrids")[11]. Within the German legal framework, this legal setup is a quite frequent choice

[11] For a simple description of „structural hybrids" and their basic financing options see also FASE: "Boosting your Growth with Hybrid Fuel" on the Empowering People Network, 2017, http://blog.empowering-people-network.siemens-stiftung.org/boosting-your-growth-with-hybrid-fuel/

of social enterprises that offer both, (1) products and services with high impact but low revenue potential, and (2) products and services that generate sufficient revenues to enable financial sustainability. From a funding perspective, if a social enterprise is set up as a structural hybrid, its not-for-profit entity can take on donations and/or public grants, while its for-profit entity is able to use quasi-equity (mezzanine) as a repayable instrument to finance its growth.

MODEL 1: MEZZANINE CAPITAL WITH REVENUE PARTICIPATION AND SOCIAL IMPACT INCENTIVE

The first model developed by FASE uses quasi-equity without loss participation and combines it with a share of the investor in the revenues of the social enterprise ("revenue sharing agreement"). This share is typically designed as a maximum percentage plus a fixed return. The basic intention of this model is to define a target return for the investor(s) but to cap the amount of the revenue share in the beginning. This allows the social enterprise to develop its business without initially paying too much for the freshly raised capital. A typical mechanism to achieve this goal is to set a cap, i.e. a certain percentage on the nominal value of the investment amount. Each year, the revenue share and the cap are compared. If the cap is lower, the investors receive the lower payment but are entitled to catch-up on their claims in future years so that they are finally able to achieve their target return.

This model provides a major benefit to early-stage social enterprises: it partly postpones the burden to meet the investors' return expectations to a later point in time when the enterprise is much more developed. This also illustrates why such financing structures are often called "patient capital": they allow the social enterprise to focus on growth for a certain number of years before investors need to see their claims fulfilled. Another important twist is that the model includes incentives for the enterprise to meet their social and/or environmental impacts. Here, impact investors are ready to waive a certain part of their target returns if a pre-defined impact goal is reached. These impact goals are typically characterized by quantity and by timing and need to be very clear to avoid potential misunderstandings or conflicts.

Altogether, this model provides the necessary flexibility to the social entrepreneur while making sure that investors are "rewarded" appropriately with respect to both, financial return and social impact.

MODEL 2: MEZZANINE CAPITAL WITH PROFIT PARTICIPATION AND SOCIAL IMPACT INCENTIVE

Model number 2 is principally equal to the first but uses a profit participation mechanism instead of a revenue sharing. Otherwise, its features are quite similar: Quasi-equity is designed with a qualified subordination clause but without loss participation, and is combined with a fixed interest rate plus a share in the enterprise's profit (EBIT). There is also a one-time final payment, defined as a range of percentages on the nominal value of the capital raised. This one-time payment only becomes due at the end of the term. The exact percentage number used to calculate this payment is depending on the level of social impact that the enterprise is able to achieve during the term of the financing. Typically, this impact goal is quantified as exactly as possible to avoid any conflicts between the social enterprise and its investors. The result of this model is a range of potential target IRRs for the investors.

Again, the purpose of this solution is to save the enterprise's liquidity in the beginning. The social entrepreneur receives enough air to breathe for growing his or her business, while investors are able to achieve both, a financial return and a strong impact by the end of the financing term.

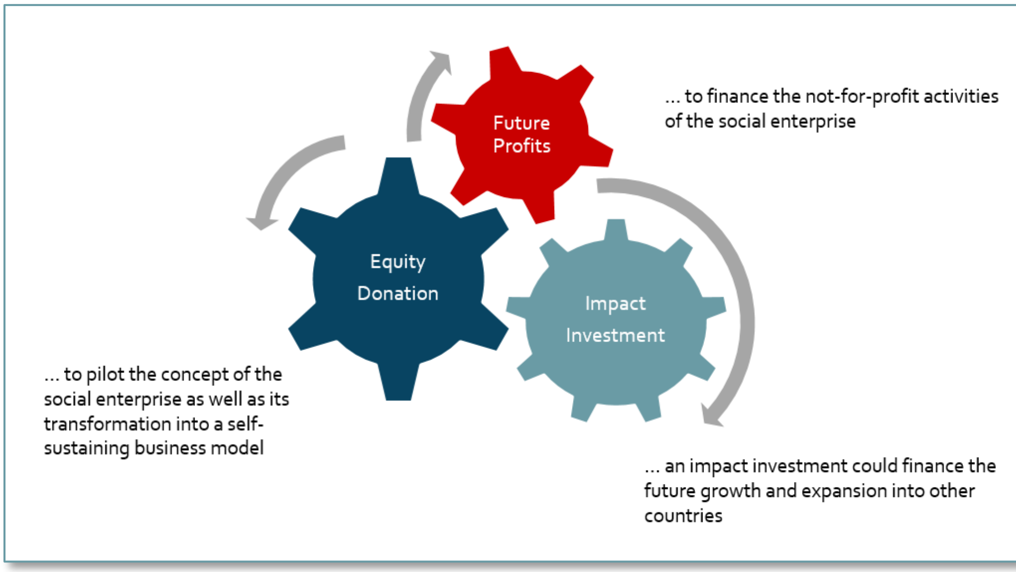
MODEL 3: EQUITY DONATION COMBINED WITH IMPACT INVESTMENT

Model number 3 is another hybrid financing approach, combining a philanthropic donation with an impact investment. A foundation, a philanthropist or a group of donors make a donation to a social enterprise that is structured as a not-for-profit vehicle. In addition, the social enterprise uses a second entity, a for-profit arm, which is set up as a fully owned subsidiary of the not-for-profit entity. A donation is then injected into the not-for-profit arm, which results in an increase of its capital stock. This enables the not-for-profit to hand over capital to its for-profit subsidiary, providing it with a sufficient equity shield. This specific component of the hybrid model is called "equity donation".

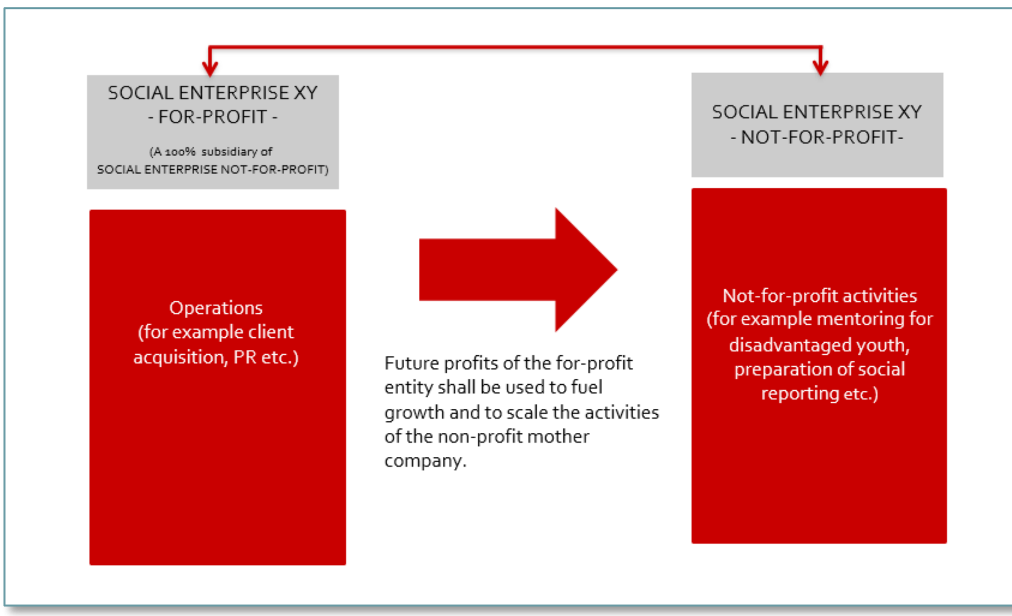
The stream of capital, originated from philanthropic sources, then prepares the ground for the next step: impact investment. The for-profit structure, now equipped with basic equity, can attract further growth capital from external investors, allowing it to expand the scale of its products and services to other beneficiaries and/or regional markets. For this part of the model, quasi-equity with revenue participation or profit participation can be used. Again, mezzanine capital in this model typically comes with a qualified subordination clause but without loss participation.

To better illustrate the impact investment part of this model, the example of a revenue participation clause may prove to be helpful: Here, the impact investors' compensation is calculated as a fixed percentage on the projected revenues of the for-profit entity. The annual payment amount, however, is limited by a cap to secure sufficient liquidity for the social enterprise in the first years. To reach the pre-defined target IRR, investors will then catch up on the difference between their revenue share claim and the payments received. This takes place in the years following the initial phase of the financing term.

Below is a neutralized example of a hybrid financing structure – and the corresponding legal setup - designed for one of FASE's social enterprise mandates:



Graph 3: "Equity donation combined with impact investment" (Source: FASE)



Graph 4: "Example of legal social enterprise structure in equity donation model" (Source: FASE)

MODEL 4: CROWD INVESTMENT COMBINED WITH IMPACT INVESTMENT

In this hybrid financing model, FASE designed a two-tier financial structure that honors the increasing importance of crowdfunding as a source of a social enterprise's financing mix. The crowd investment typically comes in the form of a sub-ordinated loan with profit participation (in Germany: "Partiarisches Nachrangdarlehen"), while the impact investment is usually classic equity or mezzanine capital.

This model provides the social entrepreneur with sufficient flexibility and allows the crowd and the equity investors to participate in the social enterprise's success. More and more social enterprises discover crowdfunding as an important source of funding - not only in terms of capital but also with respect to building a community and expanding the reach of their brands. Yet crowdfunding tends to be limited in its ability to raise larger amounts of growth capital and is usually rather time-consuming to raise for a social enterprise. A combination with impact investments from professional value-add investors can therefore be a perfect solution to achieve both goals: larger funds AND positive community effects.

The hybrid combination has even more benefits: The equity provides the social entrepreneur with an attractive equity shield and reduces the debt-ratio of the enterprise. This is a plus to the crowd investors, since (1) the social enterprise becomes more stable, (2) the risk of the loan repayment is reduced, and (3) the enterprise's chances to scale and create profits are increased. The equity investor, on the other hand, takes a higher risk but is rewarded with a higher potential return rate.

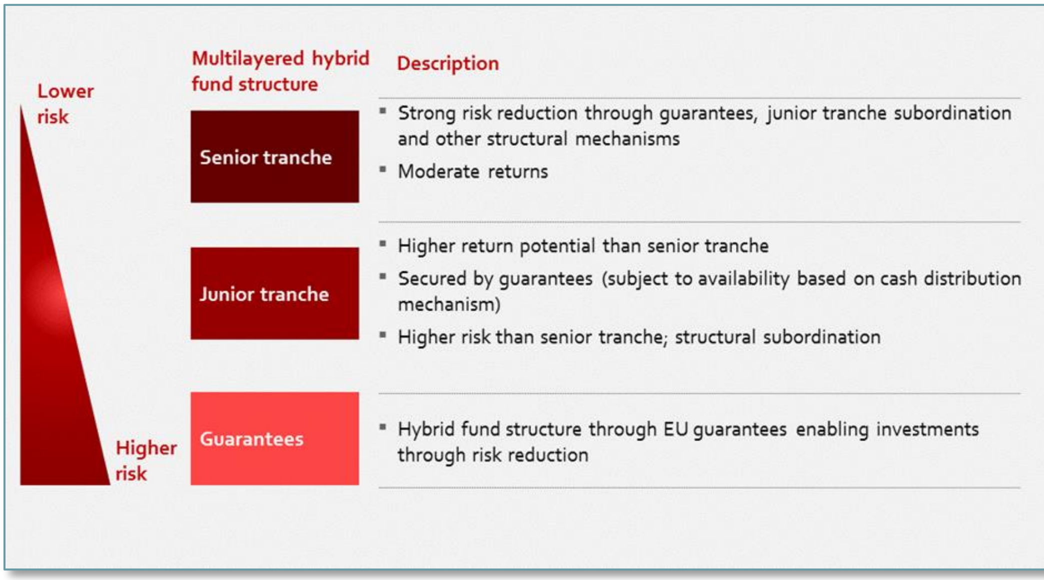
MODEL 5: HYBRID EARLY-STAGE CO-INVESTMENT FUND

As outlined before, many early-stage social enterprises are struggling to find appropriate financing. A dedicated early-stage fund structure - as it already exists for German technology companies with the "High-Tech Gründerfonds" - is still missing. To bring the scope of social enterprise finance to the next level, FASE therefore took the initiative to develop a novel fund structure called "Hybrid Early-Stage Co-Investment Fund for Social Enterprises" (working title). It is designed as a passively managed matching fund that aims to provide vital funding with equity and mezzanine capital to early-stage, investment-ready social enterprises located in Germany, Austria, Benelux and other European countries.

As a pre-condition for investment, the Fund's target investees need to have attracted one or several lead investors. The Fund's decisions will then essentially match the investments of these lead investor(s) on a pari-passu basis. Following the matching fund principle, the Fund will strictly follow a given set of clearly defined, yet rather formal investment criteria, supervised by an investment committee. Thus, this hybrid fund solution has the potential to bridge the early-stage financing gap and allow social enterprises to scale their impact after an initial proof of concept.

In terms of setup, the Fund also follows a novel approach: By applying a multi-layered structure with junior and senior tranches, it overcomes existing barriers for a substantial number of (would-be) impact investors, who often seek a more balanced and broadly diversified portfolio - as compared to entering into single direct investments. In addition, many of these investors need specific risk-return profiles to become engaged in early-stage social enterprise finance - a situation that clearly favors fund solutions. To allow for attractive financing conditions for both, investors and social enterprise investees, the fund applied for the EaSI Social Entrepreneurship Guarantee[12], which, if granted, will be an essential de-risking tool and enabler to achieve the mission. In the current social finance market, attractive fund economics for investors and reasonable financing conditions for social enterprises are one major challenge that a fund vehicle need to master to successfully achieve its mission.

The graph below briefly summarizes the multi-layered structure as a major design feature of the hybrid fund designed by FASE:



Graph 5: "Multilayered hybrid fund structure" (Source: FASE)

To further illustrate the features of the five hybrid financing models, the following two case studies will show how FASE has solved the financing riddle for social enterprises in Germany.

[12] More information on the EaSI instrument: http://www.eif.org/what_we_do/microfinance/easi/easi-guarantee-instrument/index.htm

CASE STUDIES

2.2.1. DISCOVERING HANDS

THE SOCIAL ENTERPRISE AND ENTREPRENEUR

Discovering hands® ("DH") was founded in 2006 by Dr. Frank Hoffmann, who had gathered more than 20 years of experience as a gynecologist. In 2004, he developed the basic concept of DH to leverage the outstanding tactile abilities of blind women for medical breast cancer diagnostic. This idea was mainly triggered by the decision of state health insurers to substantially reduce the coverage of preventive mammography. Due to his work as an enthusiastic change maker and advocate of social entrepreneurship, Frank became an Ashoka Fellow in 2010.

Today, DH trains and deploys visually impaired women to detect the early signs of breast cancer. During a 9-month training, they become "Medical Tactile Examiners" (MTEs), capable of delivering high-quality physical breast examinations at doctors' practices, hospitals or DH centers. The examinations follow a standardized diagnostic method that was specifically designed by DH. The social enterprise's unique approach thus transforms a perceived "disability" into a capability, opening a new field of meaningful employment and inclusion for blind women. It also has a substantial impact on women's health: Preliminary results show that detection rates for smaller tissue alterations are superior to those achieved by doctors in a standard 1-3 minute breast examination. After the conception phase (2006 to 2011), DH was able to demonstrate the viability of its business model in its core markets Germany (home market) and Austria (first social franchise region). The international scaling has recently started with pilots in India and Colombia.

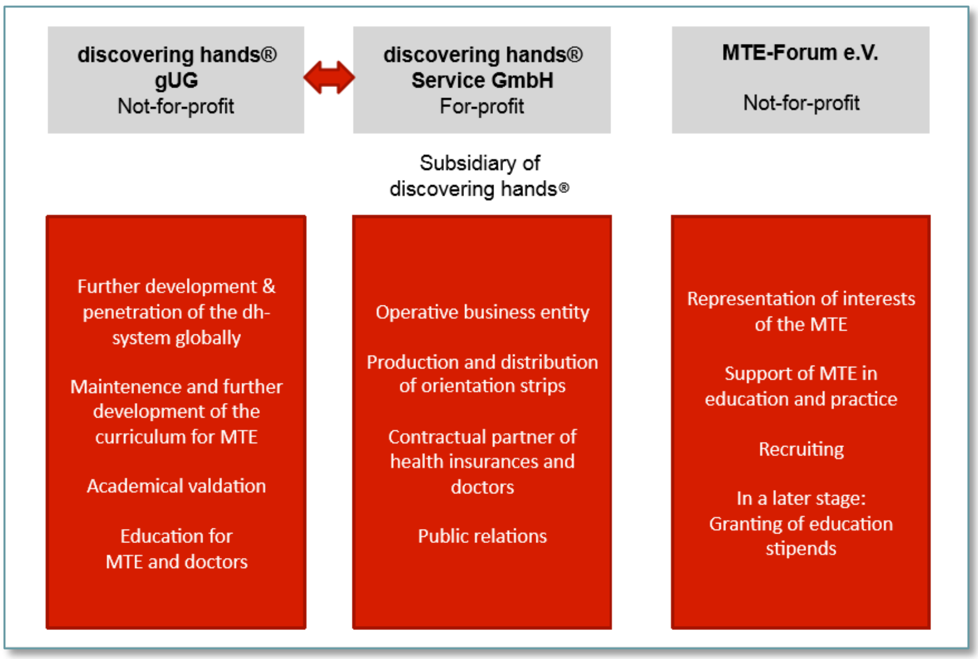
THE SCOPE OF THE SOCIAL PROBLEM

Breast cancer is on the rise, with more than 1.5 million women worldwide annually diagnosed with the disease. Death rates stand at more than 500,000 women per year and recent trends show a rapid increase - especially in developing countries due to longer life expectancy, rising urbanization and higher adoption of western lifestyles. In addition, the costs of breast cancer treatments escalate. In 2009, expenses were estimated at USD 28bn globally. The American Cancer Society calculated the potential economic loss at over USD 88bn per annum. At the same time, around 80% of visually impaired women are unemployed and/or extremely poor. Although often highly qualified, their potential through hypersensitive skills is completely left untouched - a situation that is most challenging in developing countries.

DH found a unique way of addressing both, high unemployment of blind women and prevention of breast cancer, with a scalable and adaptive business model: The enterprise builds on revenue streams from fees per examination generated by selling patented orientation stripes (a consumable used by the MTE) to physicians in the core market, as well as revenues from franchises in other countries. The examinations themselves are paid either by insurance companies or by patients out-of-pocket.

THE HYBRID FINANCING SOLUTION

Until today, FASE supported DH in successfully raising two rounds of financing. The first round of EUR 450,000 closed in late 2013 and was meant to fund the enterprise's first step of scaling within Germany as well as Austria with the help of social franchising. This step involved developing a hybrid business model, which, from a legal structure perspective, features a combination of two not-for-profit and one for-profit entities (structural hybrid). The following graph briefly outlines this legal (and business) setup:

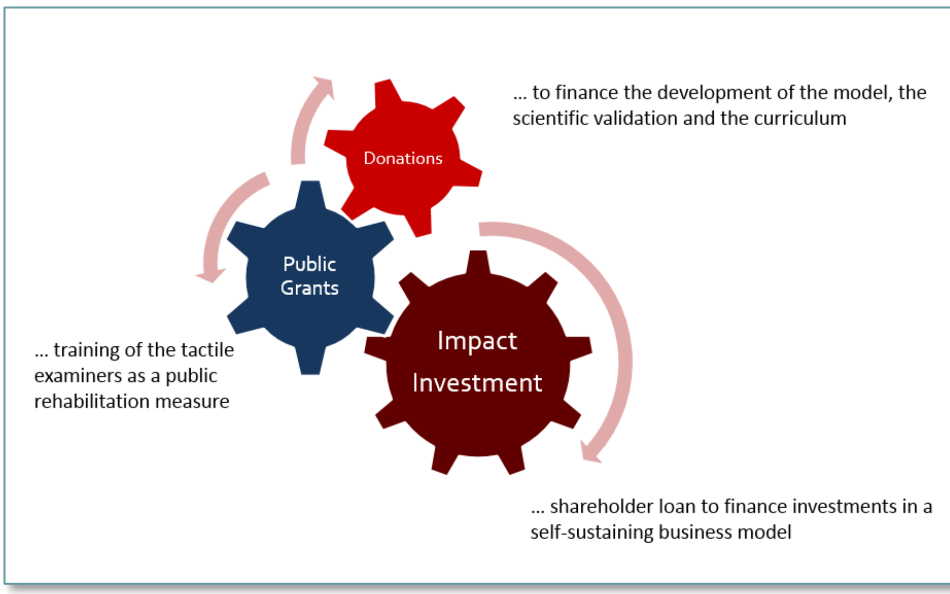


Graph 6: "Hybrid structure for Discovering Hands" (Source: FASE)

From the point of view of target investors, DH aimed to retain their existing network of philanthropists but also to attract new investors. Especially foundations were supporting the not-for-profit organization and continued to be important for the model's further development, expansion and quality management. In addition, the not-for-profit arm MTU Forum e.V. had the role as an "occupational union" for the tactile examiners (MTU) and was funded by private donations, while the costs for training the tactile examiners were covered by the public sector. A hybrid financial model therefore had to avoid potential conflicts with the philanthropic funders and create positive synergies.

It became clear that the for-profit service organization had to be financed independently, with potential profits, however, to be utilized to support the social mission. The overall goal was to create a solid and long-term self-sustaining financing system for DH. As a result, the discovering hands® Service GmbH was organized as a profit-oriented "social business". The generated profits are exclusively invested in the expansion of the business or distributed to the not-for-profit holding company discovering hands® gUG. In addition, all further stakeholders (investors) committed to transfer any dividends (if not reinvested) to the not-for-profit entities.

The corresponding hybrid financing model was based on mezzanine capital in the form of a shareholder loan. Two new investors, BonVenture (the first social venture fund in Germany) and the Kreditanstalt für Wiederaufbau (KfW, the German development bank), received minority shares in the not-for-profit holding (gUG) and the for-profit affiliated company (GmbH), and gave a subordinated shareholder loan to the for-profit arm. In terms of financial returns, the investors agreed on an interest rate in relation to the operative profit, which increases after achievement of break-even (profit participation, see model 2 under Section 2.2). The loan will be disbursed in relation to previously defined milestones and features a six-year maturity with the option for an early repayment and a grace period in the enterprise's start-up phase. Otherwise, the mezzanine capital was structured with typical information-, participation-, and approval rights for investors, and included the set-up of an advisory board. The graph below summarizes again the basic hybrid financing model designed for DH:



Graph 7: "Hybrid financing model for Discovering Hands" (Source: FASE)

INSIGHTS AND NEXT STEPS

This first round of DH – one of the very first ever mandates of FASE after being founded in 2013 – brought a number of insights into the specific challenges of financing social enterprises:

(1) Social Impact and successful businesses are not mutually exclusive - but not necessarily interrelated either. In the specific case of DH, however, the more successful the social

business model, the higher the social impact. Since social impact is so-to-speak at the heart of DH's business model, it grows incrementally whenever the business scales.

Investor-wise, there was a second important insight: (2) The more effective the solution for the social problem(s), the more likely it will attract supporters. Thus, compelling social innovations have the potential to re-define an entire sector.

The third key finding applied to the relation between business model and financing solution: (3) A hybrid business model – including the appropriate hybrid legal structure - facilitates the combination of various financing instruments for the benefit of the social enterprise and therefore allows it to build a flexible and self-sustaining financial system. In addition, philanthropic capital can become a crucial "leverage" to raise investment capital: It paves the way for developing social innovations, which allows the enterprise to successfully reach the stage of marketability.

After this initial success, discovering hands® approached FASE again for supporting its second round of financing in 2016. This time, the social enterprise's funding plan was to further manifest the model as a business in the core markets and to scale it to additional countries such as India and Colombia. In December 2016, the round finally closed with three private investors and two foundations, providing a total of EUR 800,000 in impact investment through mezzanine capital ("Genussrechtskapital").

2.2.2. ACKERDEMIA

THE SOCIAL ENTERPRISE AND ENTREPRENEUR

Ackerdemia addresses the growing problem of children losing contact to the nature of food production. Many children today are confronted with the effects of a throwaway society and a culture of food waste, which leads to unhealthy eating habits and to long-term economic and environmental damage. By teaching pupils how to produce and market vegetables on their own with the help of experts, they receive basic knowledge about food and develop a more conscious and sustainable consumer behavior. Pedagogic instructors support the process through digital gaming elements and an interactive online learning platform. This blended learning approach, combined with standardized processes to teach children about the entire food cycle, is the secret sauce in Ackerdemia's solution.

Dr. Christoph Schmitz holds a PhD in Agricultural Economics and is the founder and manager of the not-for-profit Ackerdemia e.V.. He developed the concept of the "Gemüseackerdemie" (~"vegetable academy"), which has been successfully piloted in multiple schools across Germany and made Christoph become an Ashoka Fellow in 2016.

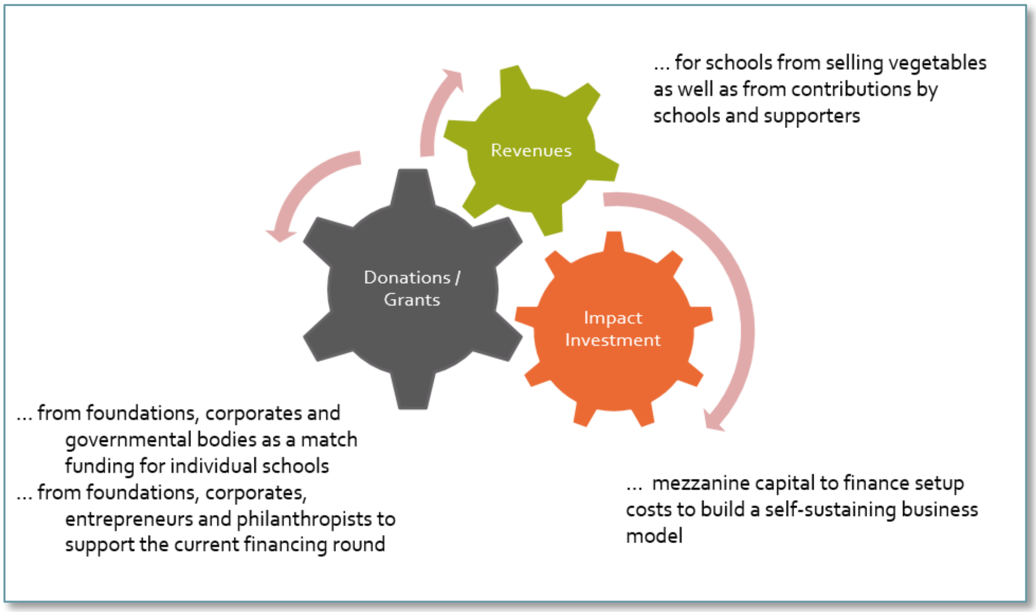
THE SCOPE OF THE SOCIAL PROBLEM

Children and young adults are increasingly disconnected from the natural cycles of food production. A strong industrialization of agriculture, combined with much shorter school curricula, substantially reduce children's exposure to basic knowledge about nature and its cycles and processes. The consequences are a much lower appreciation of food, negative consequences on eating habits and health as well as adverse economic and environmental effects. In Germany, 30 to 40 percent of edibles are thrown away, which translates into 11 million tons of food waste or a value of EUR 25 million annually. Political measures to counteract these trends – such as promoting farm visits or launching media campaigns - proved to be ineffective when it comes to a long-term change of attitude, also given the fact that these activities are not sustainably funded. Solutions developed by individual schools such as school-owned gardens, on the other hand, depend too much on the personal initiative of a small number of teachers and often suffer from a lack of specific expertise.

The "Gemüseackerdemie", however, is a scalable, impactful and self-sustaining solution based on a specifically developed curriculum. After the pupils have grown and harvested their vegetables, they sell the food via parents or "over the fence" and thus gain useful knowledge about marketing. The set-up per garden amounts to approximately EUR 1,500, with yearly expenses for the concept of approximately EUR 5,000 per school (e.g. for seeds, digital platform, and training). Due to economies of scale, expenses are decreasing over time with the sale of vegetables. A match funding from corporate partners, foundations or government bodies covers the remaining costs. The goal is that Ackerdemia becomes self-sustaining for each participating school after the initial setup.

THE HYBRID FINANCING SOLUTION

In 2016, the not-for-profit Ackerdemia e.V. approached FASE to support it in raising EUR 600,000 as a mix of donations and impact investments. The basic hybrid financing model for Ackerdemia is illustrated below:



Graph 8: "Hybrid financing model for Ackerdemia" (Source: FASE)

For the impact investment part, FASE suggested mezzanine capital (with qualified subordination clause but without loss participation), combined with a fixed interest rate and social impact incentive (see model 2 in Section 2.2). Again, the model effectively supports the mission by giving the social enterprise the necessary leeway to increase market penetration, while allowing investors to earn a moderate compensation. The social impact incentive leverages the scaling of Ackerdemia's impact and foresees a one-time payment for investors at the end of the term. This one-time payment is again depending on the achievement of pre-defined impact milestones.

Overall, investors receive their financial returns from a combination of fixed, variable and impact-related payments. This very flexible model, in turn, ensures sufficient liquidity for the social enterprise in the beginning, which is essential for its scaling plans and given its relatively early stage. Otherwise, the mezzanine capital is structured with typical information-, participation-, and approval rights for investors, and includes the set-up of an advisory board to consult the enterprise in strategic issues. The financing itself can be called in two tranches and has a term of five years. The entire financing of EUR 600,000 – including the donation part of EUR 300,000 - was successfully raised from five business angels and one foundation in 2015.

INSIGHTS AND NEXT STEPS

Similar to Discovering Hands, the case study of Ackerdemia demonstrates how philanthropic capital can be effectively deployed to finance impact scaling. Impact investment from business angels, donations from foundations and grants from public bodies go hand in hand to allow outstanding social solutions to achieve their full potential.

This is the essence of hybrid financing models: they are successful building blocks that are able to overcome current obstacles and contribute to building a thriving social enterprise finance market.

3. PAY-FOR-RESULTS SOLUTIONS

3.1. OVERVIEW OF PAY-FOR-RESULTS SOLUTIONS

Another important building block is developing and piloting models that incentivize investors - or social enterprises directly – by providing payments for positive social, measurable outcomes achieved. This is especially relevant for social enterprises that operate in market areas (e.g., early-child programs, prevention programs), where it is almost impossible to build business models that can structurally reach break-even and leverage "classical" repayable financial instruments for growth. As government funding for social welfare services diminishes, considerable attention is given to this new funding approach of pay-for-results (PFR) contracts: They hold out the promise of attracting more private investment capital to serve society's critical social needs.

There are several PFR solutions that exist in today's ecosystem. One of the most well-known structures is the Social Impact Bond (SIB), also known as "pay-for-success". At its core, a Social Impact Bond is a public-private partnership, which funds effective social services through a performance-based contract. In a typical Social Impact Bond (SIB) structure, instead of governments paying social enterprises or not-for-profit organizations to deliver services like job training, private investors provide the funding and are repaid later by the government (along with a potential profit) if the service meets agreed-upon performance benchmarks. SIBs were developed "to address systemic issues that led to poor and ineffective services for the most vulnerable and marginalized communities"[13]. Such models have seen a rise, predominantly in the UK (with only one SIB in Germany to date: Juvat, see Section 3.3.1), but are usually quite complex as they typically require a public body to join the structure as a payor for social outcomes to the investors. In addition, social enterprises usually assume the role of service providers and sub-contractors in this triangle-type of project financing and are therefore typically not incentivized for creating more impact.

A recent alternative PFR model is the Social Impact Incentives (SIINC)[14], developed by Roots of Impact and the Swiss Agency for Development and Cooperation (SDC). This model is an innovative and catalytic instrument for bringing together high-impact social enterprises, impact investors and public or philanthropic funders. Here, an outcome payer – for example a philanthropic funder, donor organization, foundation or development agency – agrees to make premium payments directly to the social enterprise based on the social contribution generated by its operations. These premiums are then paid in parallel to the revenues that the social enterprise generates through its regular business activities. In this way, impact is incentivized directly and links

[13] Social Finance UK: „Social Impact Bonds – The Early Years", 2016, http://www.socialfinance.org.uk/wp-content/uploads/2016/07/SIBs-Early-Years_Social-Finance_2016_Final3.pdf

[14] More about Social Impact Incentives (SIINC): http://www.roots-of-impact.org/siinc/

the social performance of the enterprise to its levels of profitability. This, in turn, quite naturally increases its attractiveness for investors. The temporary payments accelerate the social enterprises' process of achieving long-term financial viability, while offering the outcome funder and impact investor strong and ongoing social returns on the resources they invest.

FASE is currently in advanced discussions with several social enterprises to pilot a PFR-structure and will have a first implementation with the social enterprise Papilio (see Section 3.3.2). The idea is to have a small and lean PFR pilot, where a private philanthropists or foundation takes over the role of the outcome payer - instead of the government. Such pilot project could provide a positive example that paves the way for larger-scale applications of PFR-structures in Germany and other European countries. Government involvement would then follow in a second step.

CASE STUDIES

3.1.1. JUVAT

Today, Social Impact Bonds are still in a relatively early stage of implementation, having been tested in 60 projects across 15 countries, with 22 projects that reported performance data and 12 that made outcome payments so far (as of July 2016)[15]. After the very first SIB had started with the Peterborough prison in the UK in 2010, Juvat was launched as the first – and so far only – SIB in Germany in September 2013. The goal was to pre-finance a pilot project that should successfully place youths disengaged from education and employment in an apprenticeship or job that is subject to social insurance. This project called "Eleven Augsburg" was initiated by the Bavarian State Ministry of Labor, Social and Family Affairs, and Integration (Bayerisches Staatsministerium für Arbeit und Soziales, Familie und Integration, StMAS) as well as Juvat gemeinnützige GmbH, a not-for-profit subsidiary of the Benckiser Foundation Future. The main idea was to overcome failures in reaching disadvantaged, unemployed adolescents, who are hardly visible and much less likely to find lasting employment, which, if left unsolved, will lead to high follow-on costs for the public sector.

More specifically, the target group was defined as:

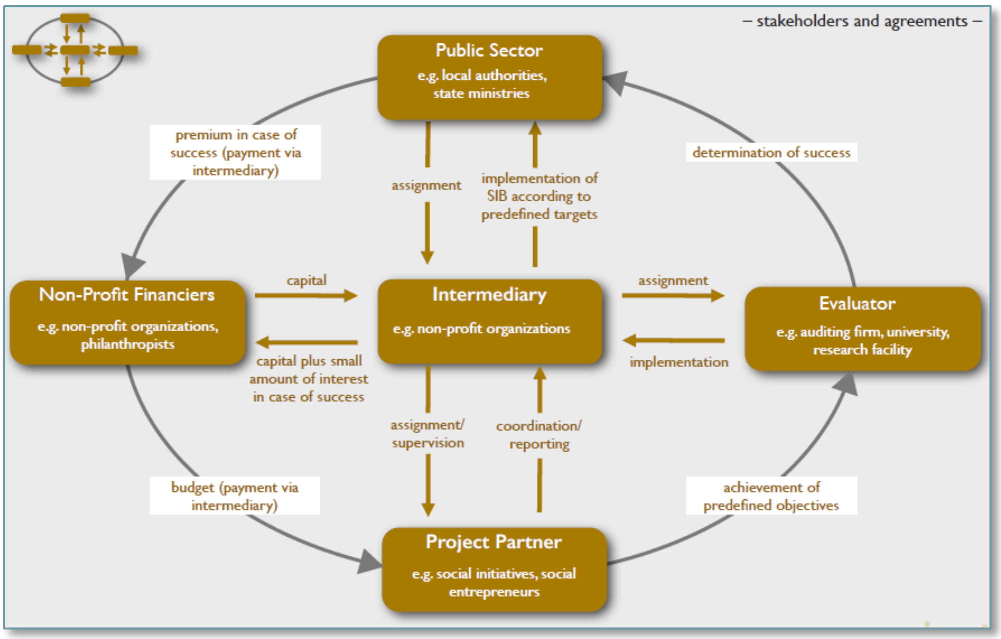
- under 25 years of age when the first contact is made,
- from the Augsburg district,
- not attending school or are no longer required to attend school and are neither enrolled in nor have completed an apprenticeship/vocational training program,
- not gainfully employed, meaning that they have not worked for more than 4 consecutive weeks in the last 6 months,

[15] See Social Finance UK, footnote 13

- not fulfilled their obligations for measures offered by the German Federal Employment Agency/Jobcenter in the two years before making contact or had no contact whatsoever.[16]

Typical to SIBs, the necessary structures and contracts were not too straightforward. They involved much complexity and stakeholder alignment, which simultaneously is also one of the biggest criticisms that SIBs are facing today. Other concerns vis-à-vis SIBs in general refer to the actual effectiveness and impact of such models, to the scope of risk transfer between the public and the private sector, and the ability of SIBs to really encourage social innovation.[17]

The following graph summarizes the basic stakeholder roles and agreements that need to be defined in a SIB similar to Juvat:



Graph 9: "Stakeholders and agreements in Social Impact Bonds" (Source: Juvat)

Upon completion of this German SIB in 2016 (the SIB term was 2 years and 4 months), the Benckiser Foundation Future reflected upon the results of this "difficult birth"[18]: Although the financiers received repayment of their loans, the SIBs targets were close to being missed, and the Foundation summarized the resulting lessons as follows:

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[16] Juvat: „10 Ways to Describe Social Impact Bonds", 2015, http://www.benckiser-stiftung.org/blog/x-social-impact-bond

[17] For example see Kristen Pue: „Social Impact bonds: Reflecting on Emerging Global Practice", in The Philanthropist, 2017, http://thephilanthropist.ca/2017/02/social-impact-bonds-reflecting-on-emerging-global-practice/

[18] Benckiser Stiftung Zukunft / Juvat: „A difficult birth – lessons from the first Social Impact Bond in Germany", 2016, http://www.benckiser-stiftung.org/blog/a-difficult-birth-lessons-from-the-first-social-impact-bond-in-germany

- All partners in future SIBs should be able to publicly communicate that they implement a SIB.
- Clear leadership and responsibilities are key to successfully align all project partners involved.
- Success controls need to replace traditional process controls to avoid double work.
- Payments for achievement of impact objectives should be relative, not absolute, to reflect "degrees of success".
- Target criteria should be as precise as possible, but also leave room for pragmatism, in order to use project resources wisely.
- SIBs should focus on lasting impact and should not be limited to short time frames, in which real success is very hard to achieve.

Social Finance UK, who launched the first SIB in 2010, also reflected on the future of SIBs in its 2016 report by raising the question of the "end game" of this financial innovation[19]: "Will Social Impact Bonds be a permanent tool in the contracting landscape, used to finance social provision on a routine basis? Or will they evolve as a tool primarily used to help government transition towards administration of outcomes-based social services directly, without the involvement of private investors? We see room in the future for both."

3.1.2. PAPILIO

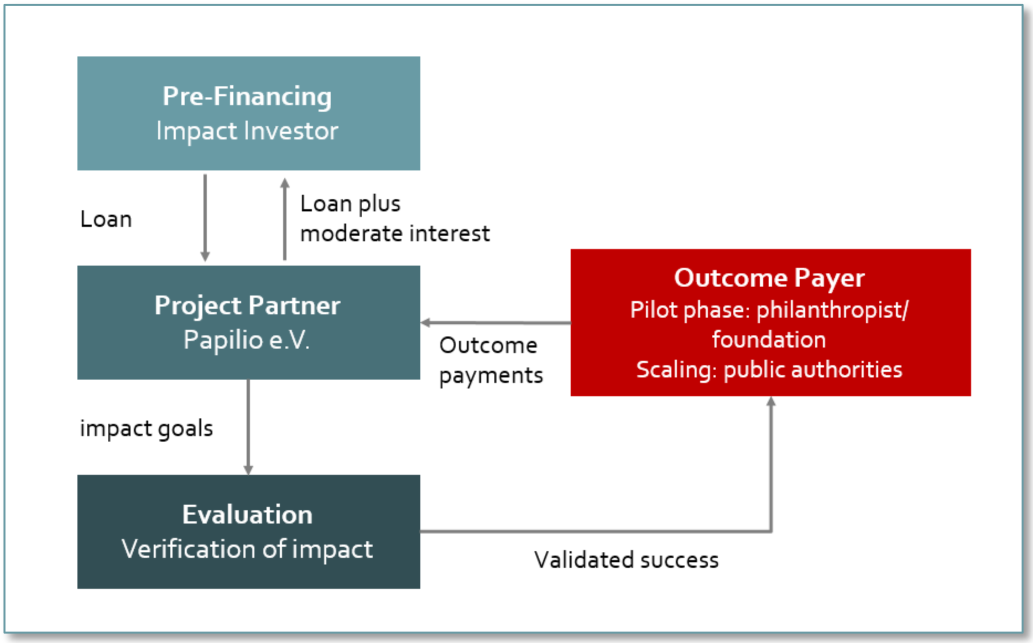
The German social enterprise Papilio e.V. developed a prevention program for kindergartens that reduces children's behavioral problems and increases socio-emotional capabilities. Papilio's program strongly contributes to the prevention of drug abuse and violence – an impact that has been scientifically verified. A study run in Augsburg, Germany ("Augsburger Längsschnittstudie", ALEPP) demonstrated that children participating in Papilio's program have significantly higher socio-emotional competences and are able to substantially reduce behavioral problems. Thereby, risk factors for children in kindergartens - such as retreat or aggressive dissocial behaviors – become less prevalent, while prosocial behavior and feelings of safety are strengthened. As a result, the public sector experiences mid- and long-term savings on social follow-on costs due to a decrease in drug abuse and violence. Yet at the same time, there is a lack of financing to further roll out Papilio's compelling solution and scale its impact for the benefit of children and society.

To address this challenge, FASE developed a financing model featuring a pay-for-results logic, which will enable Papilio to further scale its solution across Germany: An impact investor pre-finances the cost for Papilio to roll out its program in a specific geographical region. In return, the investor receives capital repayments and a moderate return once the social impact has been verified (i.e. the at-risk groups were decreased). In the first

[19] See footnote 13

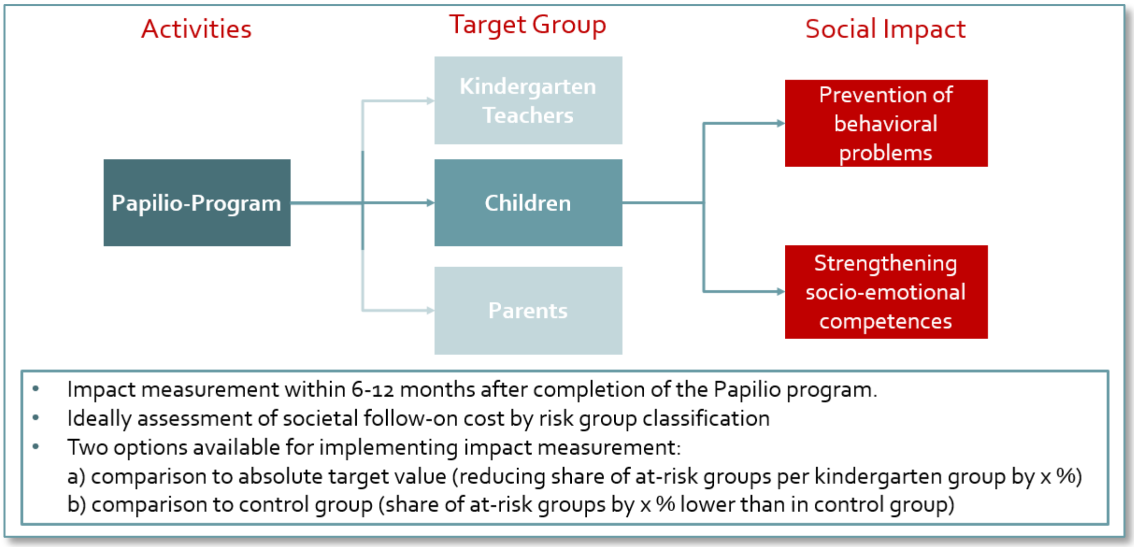
pilot, this rollout cost shall be borne by a private philanthropist or a foundation, who will act as an "outcome payer". Once the solution scales across Germany, public authorities should be in a position to step in and bear the cost by implementing a Social Impact Bond structure. The incentive for the public sector is obvious: once the effectiveness of the solution is proven in practice, there are large potential savings in social spending to be achieved.

The following graph briefly illustrates the basic model that FASE designed for Papilio:



Graph 10: "Pay-for-results-based financing model for Papilio" (Source: FASE)

In such a pay-for-results model, impact verification is a very essential task that ideally should be performed by an independent party. The logic behind the impact measurement in the case of Papilio as well as two options for implementation are further outlined below:



Graph 11: "Impact measurement as a central task in Papilio's pay-for-results-based financing model" (Source: FASE)

Papilio's financing project is currently still in an early stage, with a more detailed concept on the exact impact measurement being prepared and potential pilot regions being evaluated by the project partners.

4. LESSONS LEARNED

In the past three years, FASE has implemented the transaction support for early-stage social enterprises with the help of hybrid financing models in approximately 30 cases. As a result, a wealth of lessons learned has emerged. While these experiences are of course related to social enterprises in Germany and Austrian, they also offer substantial value to other European countries.

The following are the main insights that FASE gained with respect to various aspects of social finance - such as building investor coalitions, matching social enterprise with funders' needs, applying hybrid financial products in practice, streamlining transaction processes and setting expectations for timeframes:

DEAL-BY-DEAL APPROACH

- Although matching investors and social enterprises on a deal-by-deal basis is quite time consuming, it proved to be very effective: It typically creates the most suitable combinations of investors and social enterprises and allows customizing each investor coalition to the specific needs of the individual enterprise. In FASE's experience, impact investors often have very specific preferences about which social enterprises to invest in and which not. This phenomenon can only be appropriately considered when using a deal-by-deal approach.

- A deal-by-deal approach also allows impact investors from all financing planets (i.e. social business angels, philanthropists, social venture funds, foundations, banks, and family offices, public investors) to invest in social enterprises. In most cases, FASE builds coalitions of 2-4 different types of investors. For example, the following coalitions of investors materialized: a) a social venture fund with a public co-investment fund; b) several business angels combined; c) a business angel with a foundation; d) several business angels with intuitional investors and a public co-investment fund; e) crowd investors with several business angels and an ethical bank.

FINANCIAL PROFILE AND MODELS

- The financial risk/return profile depends on the individual social enterprise. Usually, social enterprises that FASE supports in raising growth capital are rather high-risk due to their early-stage financing focus. In addition, they typically offer financial returns below risk-adjusted market rates (e.g. IRR 4-10 %).

- Depending on the respective deal structuring, FASE often suggests a financial model based on quasi-equity for hybrid organizations (e.g. mezzanine) and on equity for pure for-profit models of social enterprises. These basic elements can then be combined with grants, loans, guarantees and co-investments.

- Regarding the general financing conditions for early-stage social enterprises, FASE experienced that deal sizes usually vary between 200k and 500k EUR and require a financing contract with a duration of >5 years. The target IRR depends much on investor preferences, but usually ranges between 4% and 10% p.a. with a pre-defined algorithm (e.g. revenue participation, social impact incentive). FASE mainly saw flexible repayment agreements at the discretion of the social enterprise, depending on its liquidity. The vast majority of financings observed involved unsecured lending.

- With respect to the expected relation between social impact and financial return that investors are seeking, there is obviously an individual factor. FASE usually observes three different types of investor attitudes: (i) impact only (typically grants), (ii) impact first (with reduced return expectations), and (iii) finance first (with market rate returns). Most investors FASE has worked with to date are "impact first impact investors", since they primarily support the social mission and want to see a sustainable business model that can return capital with a lower-than-market interest rate. In other words: most impact investors in FASE's network accept a lower financial return for a higher and measurable social impact (trade-off).

TRANSACTION PROCESS

- In FASE's experience, strict process management turned out to be an absolute "must" in order to get the financing transaction closed. A slight pressure on both, the social entrepreneurs and the impact investors, was typically the key to success. At the same time, this is often a major argument for social enterprises hiring an intermediary such as FASE: as compared to the social enterprise raising the money on its own, the fundraising process becomes more efficient and by far less time-consuming.

- Another important learning is critical mass. Only with a critical mass of interested impact investors there is a chance to successfully match a sufficient number of investors with the social enterprise. Today, FASE applies this key learning every time before signing a mandate to avoid failure in getting a deal closed.

- Regarding the length of a transaction, a key insight is that it usually takes more time than expected to convert interested impact investors into actual investors, who finally sign the financial contract. The investor community shows a lot of variance in terms of behavior and necessary periods. Some investors are very interested, regularly look at deals - and never invest. Others need at least 12 months or more before they are mentally prepared to sign their first investment.

- Investors definitely appreciate a well-prepared and pre-structured investment opportunity. Although some flexibility is necessary, FASE has experienced that good deal preparation pays off and that only 10-20% (if not less) of the term sheet conditions are finally changed in the course of the discussions and negotiations.

INVESTOR APPETITE

- In more than 3 years, FASE was able to build a network of potential impact investors that exceeds 450 private, institutional and philanthropic players. While there is a number of impact-first impact investors interested in building their own portfolios by investing directly in social enterprises, there are several factors that still need to be better addressed in the current ecosystem to sufficiently increase investor appetite:
    - To diversify risk and reduce transaction cost and time, some investors prefer fund solutions that comprise a portfolio of multiple social enterprise investees. FASE strives to address this appetite with model 5 (see Section 2.2. above) and to channel more capital into the early-stage social enterprise finance market through an early-stage hybrid fund solution.
    - While foundations seem to be rather slow movers in terms of impact investing in Germany and Austria, they have the potential to become very important and effective partners that de-risk impact-first impact investing for other types of investors. This aspect is reflected in many hybrid financing solutions that FASE developed[20] and continues to design.

[20] See also FASE / Ashoka / McKinsey: „Taking off – a hybrid investment fund to unlock the growth potential of social enterprises in Germany", 2017, http://fa-se.de/wp-content/uploads/2017/01/FASE-Ashoka-McKinsey-Taking-off-a-hybrid-investment-fund-2017.pdf

5. RECOMMENDATIONS

According to a country report run by the European Commission in 2017[21], there is a declining rate of public as well as private investment-to-GDP in Poland, which will most likely create an even higher challenge to crowd in private capital for what is considered to be a niche investment market: early-stage social enterprises.

While Poland has its own unique ecosystem, there are a number of insights, experiences and models developed in Germany, which lend themselves to serve as successful blueprints for replication. The following are the three main recommendations for the further improvement of the Polish ecosystem for social enterprise finance: (1) Providing sufficient growth capital to early-stage social enterprises, (2) Supporting the build-up of the ecosystem for social enterprise finance, and (3) Replicating the FASE model in Poland.

PROVIDING SUFFICIENT GROWTH CAPITAL TO EARLY-STAGE SOCIAL ENTERPRISES

There are still significant, almost unconquerable barriers between the mental models of philanthropists (which like to donate and "lose" 100% of their money) and impact investors (which intend to earn a minimum of >5% p.a. return). Consequently, there is almost no financing available for social enterprises that offer a great solution for a well-known social problem. These social enterprises often operate hybrid models that combine non-profit and for-profit elements. These hybrid business models often provide a potential return range between -100% and +5% p.a.. Although their models may generate significant positive external effects (e.g. savings for state or welfare system), these enterprises are still too commercial for philanthropists ("these enterprises are suspicious, because they earn income") and at the same time too social and thus financially unattractive for impact investors ("we want to save the world and earn market-based returns").

Additionally, due to disproportionally high transaction costs for financing social enterprises with deal sizes between 50k and 250k EUR, the vast majority of impact investors is waiting at the end of the investment pipeline and only looking for larger and less-risky later-stage investments with a significant track record and proof of concept. As result, there is a strategic financing gap for early-stage social enterprises (also called "death valley").

Consequently, there will be no purely market-based solution for such early-stage financing of social enterprises in Poland. The significant external effects of many social enterprises (e.g. reduced unemployment rates of disabled people, savings for the public welfare systems) are not considered adequately by many impact investors due to their strong focus on risk and return. Thus, public or philanthropic money needs to become one of the key capital suppliers for these early-stage deals of social enterprises.

[21] European Commission: „Country Report Poland 2017", 2017, https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-report-poland-en.pdf

SUPPORTING THE BUILD-UP OF THE ECOSYSTEM FOR SOCIAL ENTERPRISE FINANCE

It takes time and a lot of effort to develop a new market for social finance in Poland. This is nothing that can be achieved overnight: it is rather a mid- to long-term effort. One of the key success factors in building such a market, is the establishment of a well-functioning ecosystem. In such an ecosystem, two types of actors are especially important: (1) Social enterprise support organizations that support social enterprises in developing their business and impact models and in becoming investment ready (like Ashoka, Nesst) and (2) Intermediaries linking potential investors and donors on the supply side with social enterprises on the demand side (either social impact funds or match makers / transaction consultants like FASE).

These social enterprise support organisations and intermediaries working in the area of financing deals below 250k EUR will not be able to develop economically sustainable business models for their own operations due to the disproportionally high transaction costs for such "small deals" and the limited return potential. Thus, these social enterprise support organisations and intermediaries will remain in need of public or philanthropic money in addition to proprietary earned income to cover their full costs (something which is already fully acknowledged for the field of commercial and technical start-ups which already get the respective infrastructure / capacity building support of public authorities across Europe).

REPLICATING A FASE MODEL IN POLAND

FASE has supported social enterprises in Germany successfully in raising growth capital on a deal-by-deal basis. Through coaching and consulting services we enabled these social enterprises to attract growth capital across the often rigid boundaries between donors, investors and the public sector. We have developed hybrid financing models that successfully combine different types of investors and donors. We intensively piloted and tested these models with our projects for transaction support, providing the social finance sector with blueprints of appropriate financing solutions that can be replicated by other investors/donors and social enterprises in Poland.

From our perspective, the critical success factors to replicate such a FASE model with an orchestrated investment approach in Poland are as follows:

- A relatively low complexity of the developed financing models so that a wide range of financial instruments can be integrated into fine-tuned packages.
- Affordable transaction costs of such an orchestrated approach. Otherwise, it will be too expensive to replicate.
- General openness of social enterprises and impact oriented investors to replicate the identified financial instruments and role models.
- Transferability of identified financing models of cooperation between investors and intermediaries on a deal-by-deal basis from our pilot region (i.e. Germany) to

Poland. This involves the question of adequate legal frameworks and low costs for the adaptation of these models.

In our view, other intermediaries in Poland could follow a similarly staged investment process to support social enterprises in raising growth capital. This involves a customized consulting concept to build individual coalitions between different impact investor types. The intermediary needs to build a regional network of impact oriented investors from all financing planets and to understand the investment preferences of individual investors. This is the basis for matching them with individual social enterprises. Additionally, the intermediary needs to select potential social enterprises according to their specific target profiles and consult with them in all questions of planning, organisation and coordination of a transaction process.

Altogether, given a necessary investigation of differences in legal framework and the resulting adaption of financing models, the basic hybrid financing solutions outlined in this paper should serve as powerful best practice examples for an improvement of the ecosystem for social enterprise finance in Poland.

LIST OF GRAPHS