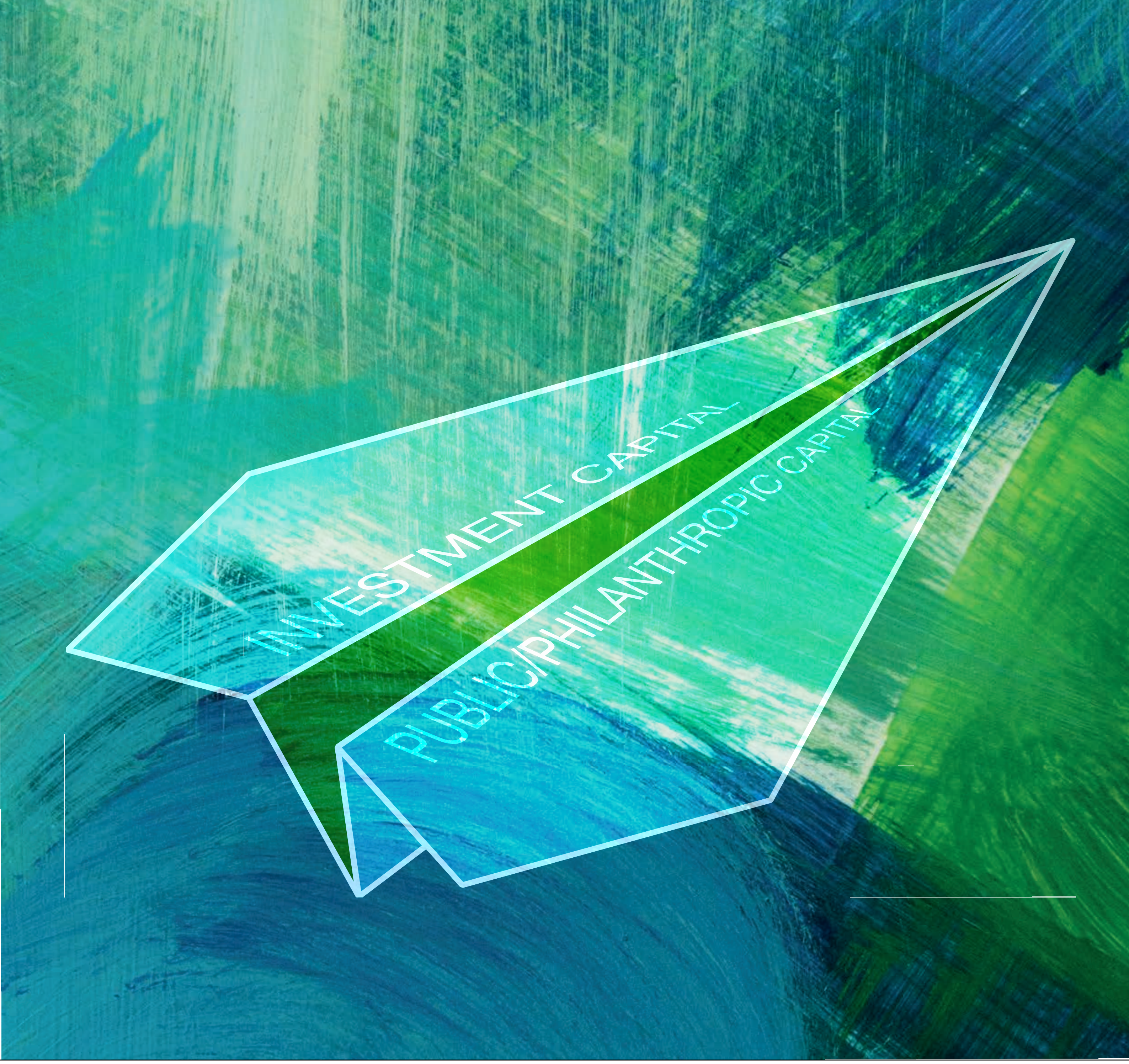

Taking off

A hybrid investment fund to unlock the growth potential of social enterprises in Germany

FASE
ASHOKA
Eberhard von Kuenheim Stiftung
Stiftung der BMW AG
BMW Stiftung Herbert Quandt
ab jetzt gemeinsam
McKinsey&Company

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Contents

Executive summary

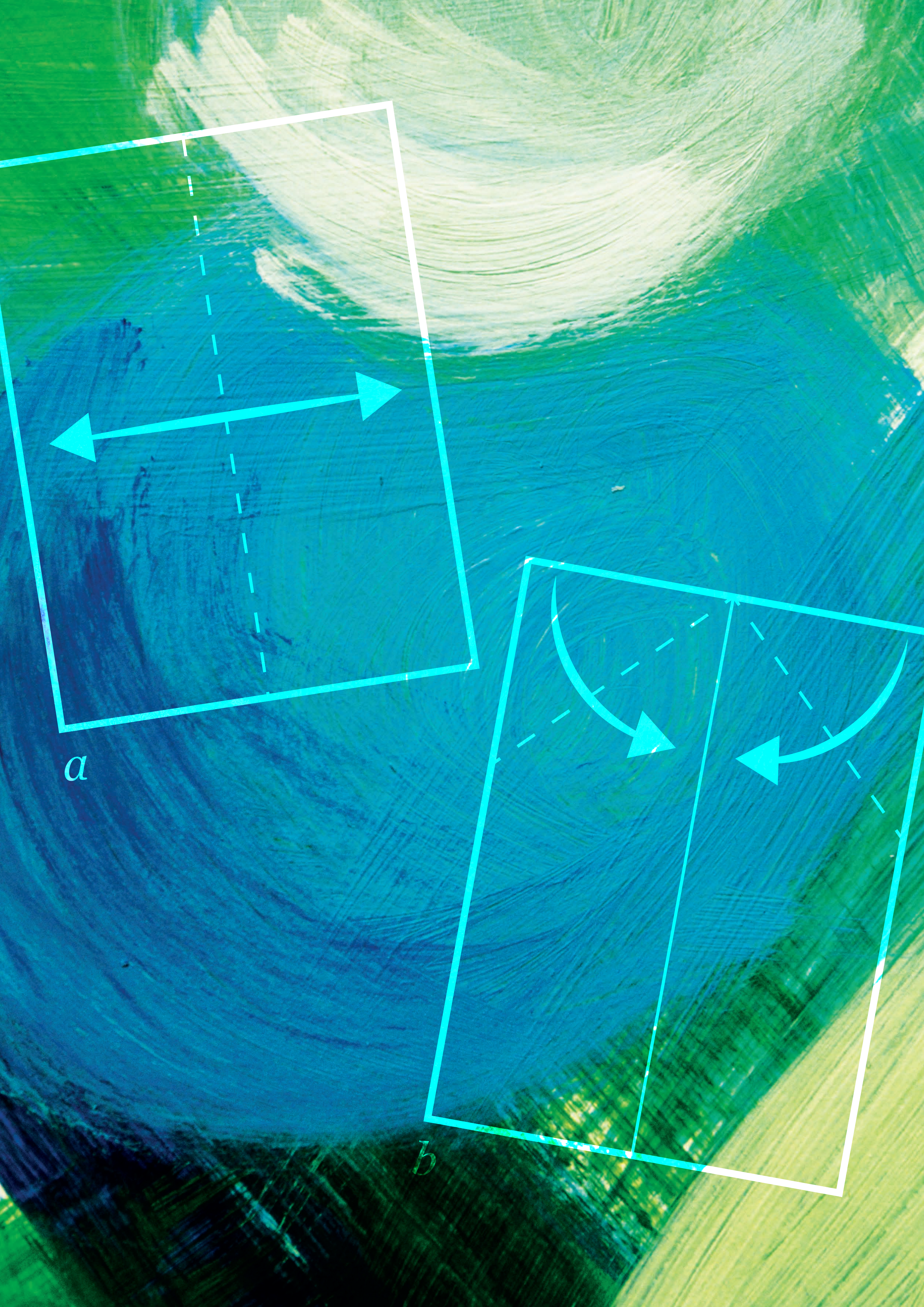
Investing for profit and for the philanthropic use of financial resources are still commonly perceived as different, disconnected worlds. Nevertheless, the awareness for impact investing – investments that yield both a social and a financial return – has risen in recent years. In the previous report "Achieving impact for impact investing," we examined the state of impact investing in developed countries and found a significant growth potential due to the missing funding opportunities for social enterprises. Therefore, we have now designed a practical fund concept that facilitates the large-scale support of social start-ups and unlock the growth potential of impact investing.

Entrepreneurship's potential for innovative social solutions is hindered by limited investment/funding opportunities. As advocated in the previous study, investments combining social impact with financial returns have significant potential to support the innovative solutions that are required to tackle the social challenges in developed countries. Oftentimes, the most creative solutions originate from entrepreneurial social activities. Impact investing can help fund such activities, resulting in both improvement of social challenges and attractive investment opportunities. So far, the ecosystem for impact investing is still below its potential in many countries, such as Germany, and this severely affects the ability of small social enterprises to scale their businesses. Mainly based on the high cost of investing into small businesses with small investment sizes, only very limited funding is available to support their growth.

Combining investment capital with philanthropic and public capital could close the financing gap for these young social enterprises. Today, investing for profit and the use of philanthropic capital are commonly practiced disconnectedly, focusing on either highly developed and profitable or on donation-dependent social organizations, excluding many young social enterprises operating in between those ends from access to financing. The combination of philanthropic and investment capital in a hybrid fund can close this gap by making the investments attractive to different types of investors. Financial investors benefit from attractive risk/return/impact opportunities, while public and philanthropic capital providers benefit from a social multiplier effect of their capital.

Hybrid funds could support the scaling of social enterprises and offer investments with social as well as financial returns. A hybrid fund as proposed here would support innovative social enterprises ready to scale their business, with income sources that are both market-based and hybrid, meaning a combination of donations and revenues. For investors, the hybrid fund could offer different opportunities with tranches with various risk/return/impact profiles: financial investors with a lower risk appetite and lower return expectations of 2 to 3 percent, for example, could invest in a senior tranche. Those with a higher risk affinity and return expectations of 3 to 5 percent could channel their capital into a subordinated junior tranche. These returns can be achieved through the hybrid fund approach, with public capital to grant credibility by partly covering capital losses for both investment tranches in this specific example, and thus enable the support of small social start-ups.

Cooperation among key partners is important in the establishment of a hybrid fund. The implementation of the hybrid fund requires the support of pioneering partners. Alongside the fund management, a fund sponsor and an anchor investor are seen as essential to put the fund into practice. Once implemented, such a hybrid fund with focus on small scaling enterprises can unlock the pipeline of social enterprises and thereby have a multiplying effect on the growth of the impact investing market.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The opportunity

Combining social impact with financial returns to support solutions to social challenges

Developed countries continue to face well-known social problems while new ones emerge. In Germany, for example, consistent levels of long-term unemployment, continuing obstacles to social mobility and, more recently, the admission and integration of unprecedented numbers of refugees and asylum seekers are examples of some of the most pressing challenges to be addressed. In addition to the individual hardship some of these social challenges cause, the societal costs are immense. For Germany, a potential investment need of nearly EUR 50 billion in 2025 has been estimated to address only a few selected social challenges[1].

Innovative solutions are required to tackle social challenges

While the government is addressing many of those challenges with large programs, social entrepreneurs with innovative and agile solutions can significantly contribute to solving these problems. These entrepreneurs typically address social challenges with creative, flexible, and fast approaches, combining social impact with financial returns. Social start-ups addressing the needs of asylum seekers have recently demonstrated the power of entrepreneurship to create fast responses to challenges, working on a wide range of areas, such as organizing volunteers, delivering educational programs, or launching job search portals. Their involvement plays an important role in providing relief in the short term and in supporting the integration of immigrants in the long term.

From an entrepreneur's perspective
"We were able to understand the unique needs of a really hard-to-reach population – particularly the needs that government agencies had difficulty addressing – and had a solid plan for delivering solutions. The hardest part was bringing our proven model to market."

1 "Achieving impact for impact investing," 2016.

Impact investing can help fund solutions to social challenges and provide attractive investment opportunities

A large opportunity for such support of social start-ups is impact investing. Impact investing refers to investments that support social or ecological enterprises, combining social impact with financial returns.

Globally, the market for impact investing has been growing at high rates of approximately 30 to 50 percent p.a.[2] during the last years. This trend is expected to continue, as capital markets exhibit favorable conditions for new investment strategies and abundant capital needs to be matched with suitable investment targets. In this model, lower financial returns are acceptable, as long as investments exhibit low market and low interest rate correlation, thereby offering opportunities for diversification. Among comparable low-yield assets, the social-impact dimension may gain even further importance in investment decisions. Therefore, the growth of impact investing is expected to continue, both in emerging and in developed countries.

Internationally, various financial instruments have been developed, such as investment funds or social impact bonds. By providing investment opportunities with different risk/return/impact profiles, an increasing range of investors can be attracted and the social impact increased. Examples of these funds include the Acumen fund that invested USD 100 million globally into breakthrough innovations to reduce poverty, or Social Finance, which raised funds of GBP 100 million in several social impact bonds during the last years in the UK, the US, and Israel. In Germany, a few investment funds have been established during the last years (e.g., BonVenture, Ananda), which focus mainly on more mature start-ups with bigger investment volumes.

Biggest growth potential with support of young social start-ups ready to scale their business

Impact investing is still a niche market in Germany, with only about EUR 70 million in assets under management in 2015. A number of factors currently hinders the implementation of international innovations and thereby the growth of impact investing in Germany, including a lack of investors, investment-ready entrepreneurs, financial intermediaries, and a supportive regulatory framework. One of the key inhibitors, however, was found to be the lack of available financial instruments connecting potential investors and social start-ups[3].

From an entrepreneur's perspective
"There was no shortage of organizations and individuals who wanted to back our work. What was missing was the right investment vehicle that would allow them to do so."

While financial support is (at least partly) available for more mature start-ups and for established organizations, a lack of support is especially noticeable for young social start-ups that have just proven their business models and now want to grow. In this phase, they typically need support to, for example, expand and professionalize their team, establish new sites, further develop their service/product, or build new customer channels.

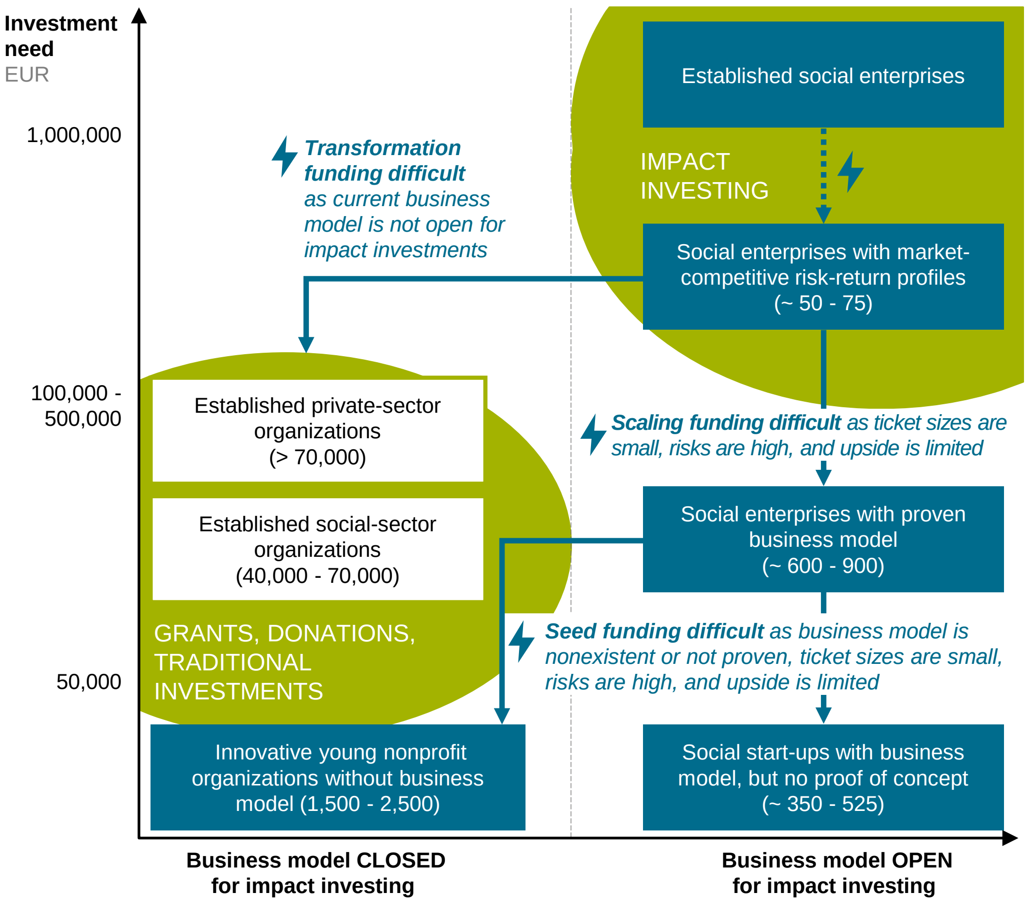
2 European SRI Study 2014, Eurosif.
3 "Achieving impact for impact investing," 2015.

This gap in financial support for young social start-ups is mainly caused by the high effort of screening, support, and impact measurement necessary for each small investment. This leads to high management cost per investment combined with the often smaller returns of social enterprises. As a result, the lack of financial support for scaling start-ups is self-reinforcing as it limits the development pipeline from young start-ups towards more mature enterprises with broad reach and readiness for further investment, thus hindering the growth of impact investing and social enterprises. In Germany, for example, an estimated 600 to 900 young social start-ups with proven business models and growth potential are currently active, but only about 50 to 75 mature social enterprises with market-competitive returns exist due to the insufficient funding support in earlier phases[4].

Therefore, the availability of financial support for scaling social start-ups will be key to unlocking the growth potential of impact investing. In the following chapters, we will describe a concept for a hybrid investment fund that offers investment opportunities with attractive risk/return/impact profiles and provides support for young social start-ups to scale their businesses.

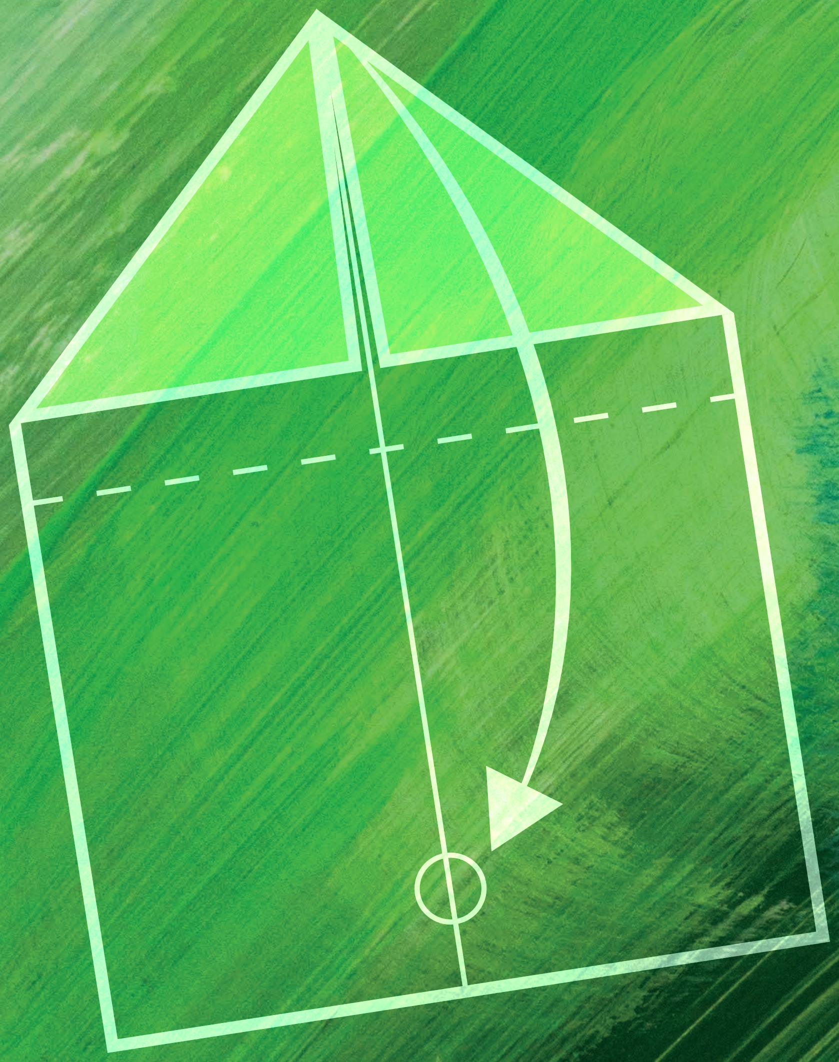
Exhibit 1

The investment pipeline is blocked at several points, limiting the number of social entrepreneurs to around 50 to 75 organizations



Source: Centrum für soziale Investitionen und Innovationen der Universität Heidelberg (CSI); expert interviews; McKinsey analysis

4 "Achieving impact for impact investing," 2015.



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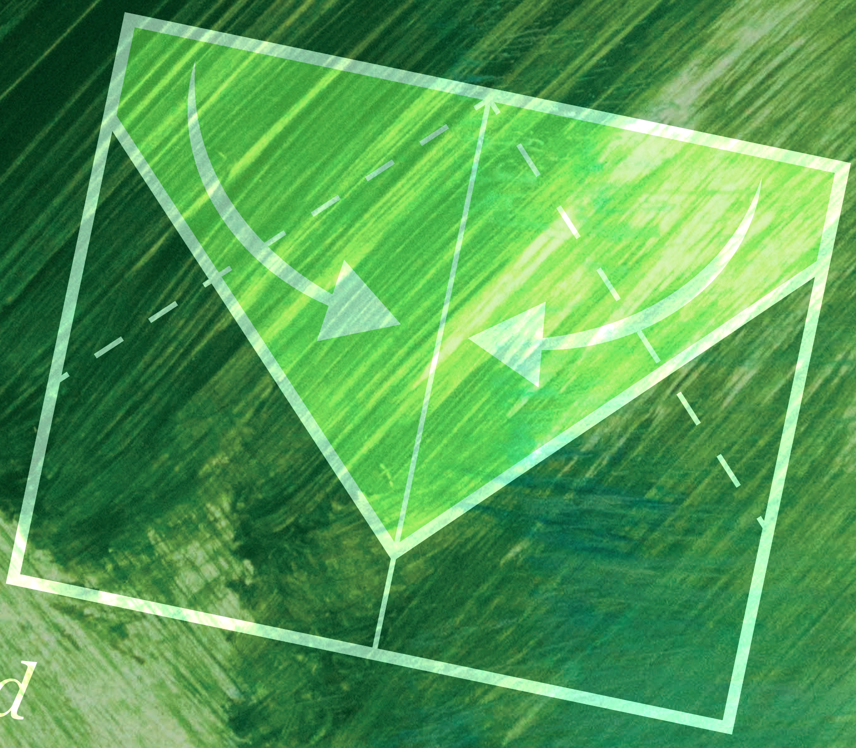

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The missing link

Hybrid funds to finance young social start-ups

Today, investing for profit and the use of philanthropic capital are commonly perceived as two separate worlds. Financial support ranges from donations on one end, to investments with (nearly) market-competitive return expectations on the other end of the spectrum. Today, most support is provided at these two ends of the spectrum, which serve different types of investors. However, many social start-ups have business models that do not fit the needs of these two ends of the spectrum, and hence currently do not have appropriate access to financial funding.

Philanthropic financiers usually donate directly to a limited number of social organizations, first and foremost seeking social impact and disregarding financial returns. Thus, they typically do not receive any of their money back, despite the fact that some social start-ups would be able to repay grants after a few years, thus unnecessarily limiting capital utilization. Foundations are among the most relevant providers of philanthropic capital in Germany. Due to regulations, their philanthropic support is limited to nonprofit organizations, excluding social start-ups with for-profit business models.

National public authorities typically do not invest directly in specific small enterprises, and historically have been minimally involved in facilitating the support of social enterprises. Recently, however, this seems to be changing with the emergence of a few social start-up-focused government programs from the European Commission (e.g., the EaSI program offering guarantees for social impact investing funds).

Impact-oriented financial investors provide investment capital for social enterprises. They see social impact as an objective, but also aim for financial return. They often do not support social enterprises directly, but tend to channel their capital into impact funds. So far, those funds invest mainly into more mature start-ups that allow for larger ticket sizes and often show higher profitability. Funds supporting smaller (i.e., scaling) social start-ups would face difficult economics: while small social enterprises do allow for profitable investments, the small ticket sizes mean a high number of investments with low absolute returns. The effort of screening, support, and impact measurement necessary for each small investment is high. Those costs, together with the small investment and return sum per enterprise, lead to high management fees and small or even negative returns at the fund level.

Exhibit 2

Hybrid fund can support start-ups that currently do not have access to funding

Current investment situation | Investment situation with hybrid capital

Philanthropists	Hybrid capital investments	Impact-oriented investors
Donations/grants directly into non-profit social start-ups	Investments into young social start-ups with smaller ticket size and potentially more “complex” or less profitable business models	Investments into funds supporting mature start-ups (i.e., with high ticket sizes) Selected direct investments into highly profitable start-ups

EXPECTED RETURNS

-100% | 0% | >> 0%

As a result of this disconnection and high cost, many social start-ups do not have access to financing today. Investors are mainly attracted by mature social start-ups, and philanthropists support a small number of mainly nonprofit organizations without “commercial” returns. Today, however, there are many forms of organizations in between donation-dependent and high-profit – those that operate partly on donations, partly on generated income, and those that will break even and generate moderate profits in the future. So far, these start-ups do not fit any of the financing possibilities.

From an entrepreneur’s perspective

“It’s not that impact funds haven’t existed for a while, but they focused on start-ups that were in later stages of maturity than we were. We were ready to scale but were still too small to be considered by most funds.”

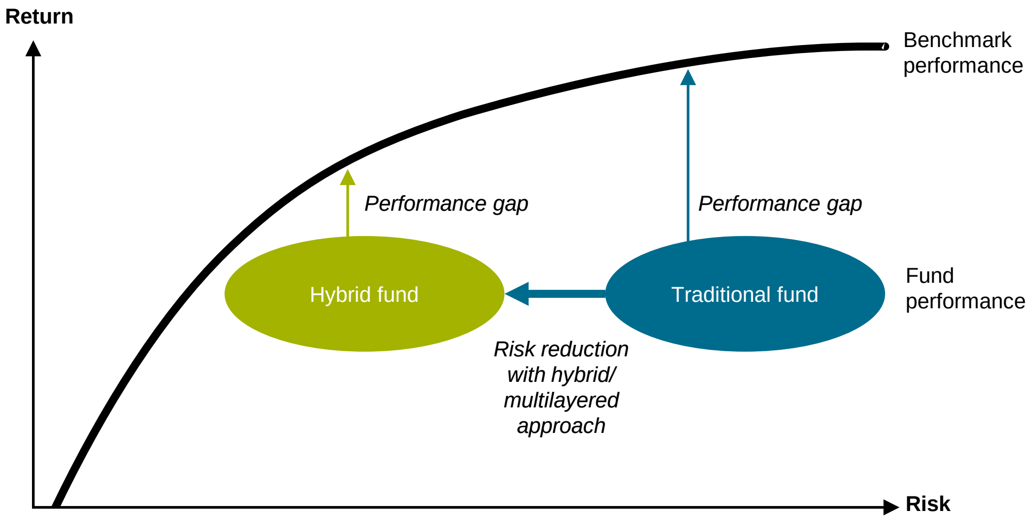
Hybrid funds bridge this gap and create a win-win-win situation for investors, public and philanthropic partners, and the social start-ups. This dilemma could be solved by combining philanthropic, public, and investment capital into a single financial vehicle. This so-called hybrid fund would combine investment capital that goes into the start-ups with guarantees from public authorities to partly cover losses and potentially grants, for example from foundations, to cover costs of the fund.

With these additional types of capital, a fund supporting social start-ups could offer attractive investment opportunities for investors and at the same time allow public authorities and philanthropists to increase their impact through leveraging additional capital. Such a fund could provide financing access to social start-ups with a wide range of company sizes and business models and, specifically, also to young, scaling social start-ups that currently lack suitable funding sources. With this hybrid capital structure, the fund could attract large volumes of investment capital that currently are not invested with social impact due to insufficient investment vehicles, and ultimately unleash the potential of social innovation.

Public and philanthropic capital providers benefit from the multiplier effect. The hybrid fund allows philanthropic investors and public authorities to significantly increase the reach of their capital and advance social entrepreneurship and impact investing – areas that are of high interest for institutions that are entrusted with creating and implementing solutions to social challenges. The multiplying effect is based on the much higher amount of capital that is used to support social start-ups for each unit of capital the philanthropic or public financiers provide. That way, their capital can support a larger number of social organizations and thus generate a bigger social impact for society.

Exhibit 3

Investor risk/return expectations



Investors benefit from attractive risk/return/impact opportunities. The public or philanthropic capital would be used to improve the risk/return/impact profile of the hybrid fund. Typically, the philanthropic/public capital is used in two ways. Capital loss guarantees from public authorities could reduce the risk and default burden of investors. Loss guarantees come into effect if and only if portfolio companies default on their payments. Guarantees would usually cover part of the defaults, so that investors bear the burden only partially. Grants could cover some of the running costs a financial vehicle has for screening potential investments, supporting them in their development and ensuring high-quality social impact measurement as well as the legal fees that occur for each investment. Those two measures thus enable the fund to offer risk/return/impact levels that are attractive for impact-oriented investors.

With this approach, by combining public, philanthropic, and investment capital, the requirements of both hybrid capital providers can be met. Together, public authorities and philanthropists can achieve greater reach and impact in their goals than they would be able to on their own, while impact-oriented investors gain access to an appropriate instrument to invest capital with both returns and social impact. Therefore, the fund is able to attract sufficient investment capital to support scaling social start-ups at large scale and thus fuel growth of the overall impact investing market.

Deep dive: Impact investing allows foundations to significantly increase their social impact in Germany

Foundations play an important role in supporting charitable activities in Germany. They control capital in excess of EUR 100 billion and spend several billion EUR each year in pursuit of their charitable missions. The assets of foundations vary noticeably in Germany: while 5 percent of the foundations have more than EUR 10 million, about 75 percent have endowments smaller than EUR 1 million. About half of German foundations focus on social topics in their mission[5]. Therefore, foundations are a natural partner to support social enterprises, and many are already involved in such activities.

However, even foundations consider “investing” and “donating” as two separate worlds: their endowment capital is typically invested with the goal to maximize financial returns with little or no attention to social impact, and only these returns are then used to fund charitable activities (e.g., to finance their own operations or as grants to support others). This approach not only limits the social impact foundations can achieve, but it will also lead to shrinking relevance of foundations in the future as returns on invested capital are expected to remain low.

Impact investing would enable foundations to follow a more holistic approach to pursue their missions, by using both endowment capital and grants with social impact. This would allow foundations to expand their social impact in the future, even in times of shrinking proceeds of investments that can be used for grants. In the following, this is illustrated for three typical profiles of foundations.

Small foundation with an endowment of approximately EUR 5 million. The financial returns are not sufficient to support the mission with grants after costs have been covered, and additional fundraising shows limited success. The foundation thus considers merging with similar foundations in order to remain active, at the cost of changing its mission and losing influence. However, by combining endowment capital (e.g., investment into impact investing fund) and grants (e.g., support of hybrid fund with cost grant; direct support of social start-ups or charities in parallel to a fund), this foundation could remain independent and continue to pursue its social mission directly through its investments.

5 “Zahlen, Daten, Fakten”, Bundesverband Deutscher Stiftungen, 2014.

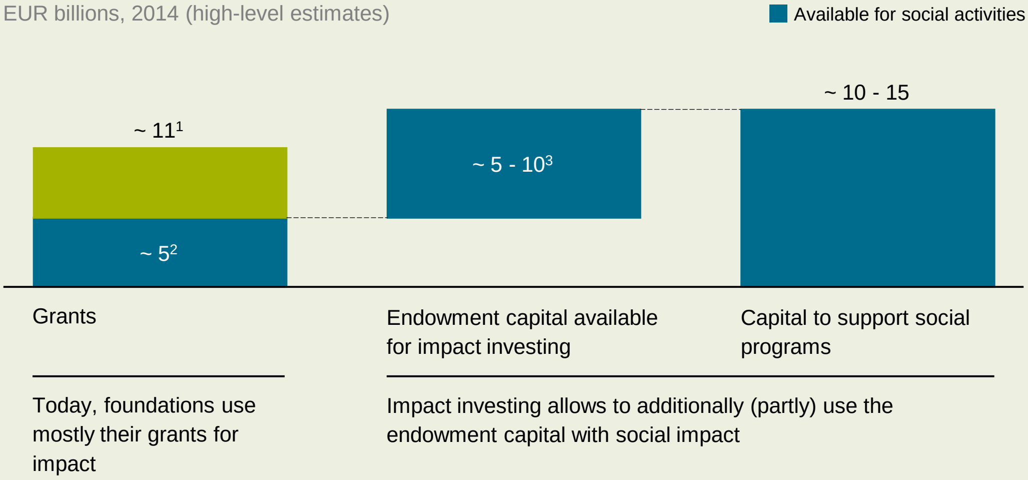
Company foundation with endowment capital of approximately EUR 150 million and additional support through donations of several million EUR per year. This capital flow could be (at least partly) treated as "free reserves" which allow for higher flexibility and investments with higher risk. The foundation could therefore use significant capital either to support social start-ups directly, or to invest the capital in higher-risk tranches of funds and thus leverage further capital to support social start-ups and increase its social impact.

Large foundation with endowment of more than EUR 1 billion. Already today, a noticeable portion of the endowment is invested with social impact, such as real estate for social organizations and shares in cooperatives, but not yet in social innovation. The foundation plans to further invest endowment capital with social impact and to extend the scope, e.g., to support social start-ups, and thereby further increase its reach and social impact.

Exhibit 4

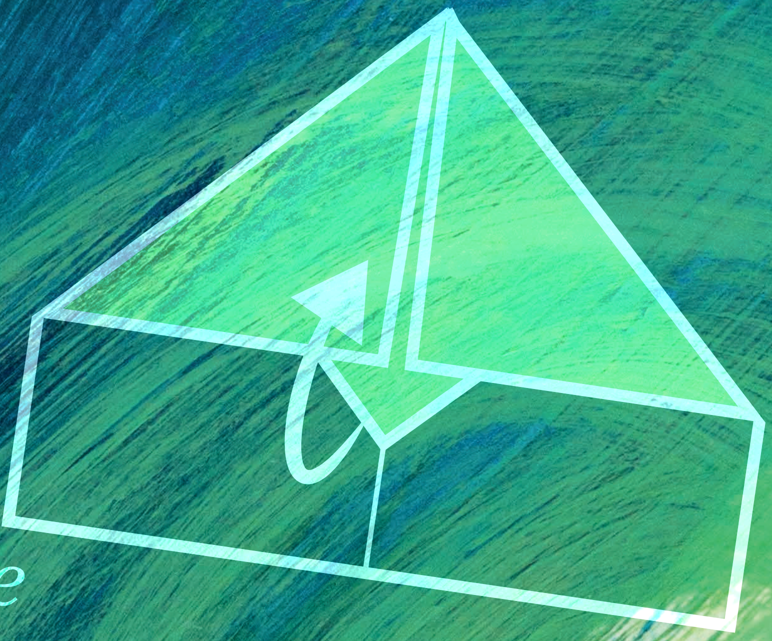
By using both their grants and their endowment capital to support social activities, foundations can significantly increase their social impact

EUR billions, 2014 (high-level estimates)



1 Assumptions: total income of foundations of ~ EUR 17 billion; about 50% of income from invested endowment capital of which min. 66% can be used as grants; assuming 20% of administrative expenses
2 About 50% of foundations with social mission (social activities; education; health)
3 Foundations with ~ EUR 100 billion total endowment capital; assumption: about 50% total endowment from foundations with social missions; up to 10 - 20% of their endowment could be used for impact investing

Source: Bundesverband deutscher Stiftungen (Zahlen, Daten, Fakten, 2014); team



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Getting real

A fund to support scaling social start-ups and offer attractive investment opportunities

Social enterprises can play a significant role in solving social challenges. Their potential, however, has not yet been fully realized. This is mainly due to the lack of funding for social start-ups to scale their business, which would be required to unleash the full impact of those organizations. Connecting the capital of public authorities and philanthropists with that of investors would allow both groups to better fulfill their goals. At the same time it would help closing this financing gap of young social start-ups and thereby boosting the market development.

To put this in practice, a concept for a hybrid fund that combines financial returns with social impact has been developed. The fund would provide moderate financial returns (i.e., 2 to 5 percent internal rate of return across different investment tranches).[6] The proposed fund volume is EUR 40 million, which would support around 100 social start-ups over a ten-year period, of which the investments would be conducted during the first five years. However, the fund concept allows for some flexibility regarding smaller or bigger volumes.

The portfolio: Innovative social start-ups ready to scale their business, with hybrid and market-based income sources

The fund focuses on innovative social enterprises whose primary goal is to solve a social problem or to improve a socially difficult situation, together with a clear business plan with measurable social and financial KPIs towards this goal. The fund is open to enterprises from various sectors; it is expected that education, health, and employment-related ideas will dominate. The enterprises can be both nonprofit and for-profit organizations. In determining the portfolio, social start-ups are categorized according to their sources of income and their maturity. Depending

6 In the financial returns of 2 to 5 percent specified above, the full management costs are considered.

on the company profile, their needs – in terms of investment size, investment instruments, and nonfinancial support – will differ.

As mentioned above, revenues of social enterprises can, unlike those of regular start-ups, have two sources: donations and commercial revenue. Revenue can be 100 percent donation-based, 100 percent market income-based, or a hybrid representing all possible combinations of both donation and market income revenue. It is important to note that start-ups do move along this continuum as they develop. Many begin with at least part of the operations being funded through donations, while continuously reducing the fraction of the donation as market income grows, eventually breaking even. The fund will support start-ups that are purely market-oriented, as well as the market-oriented activities of start-ups with hybrid business models.

Exhibit 5

Focus of initial fund on portfolio companies with significant share of commercial revenues

ROLE OF SOCIAL ENTERPRISE

	-100%		0%	+X%
Business model	**Donations**	**Hybrid – focus donations**	**Hybrid – focus market income**	**Purely market income**
Source of capital/ income	Only philanthropic capital	Mostly philanthropic capital, some commercial income	Mostly commercial income, some phil-anthropic capital	Purely commercial income

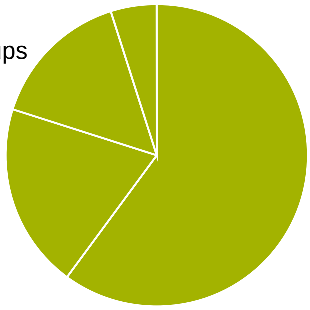
Focus of initial fund

The fund would also take maturity or development stage of the start-ups into account. Young start-ups will have shown an initial proof of concept of both the business and the impact model and now need to scale their product or service to gain a foothold in the market. Typically, those companies need between EUR 100,000 and EUR 500,000 in capital. Mature start-ups will have already successfully persisted in the market in both the business and impact dimension for some time. For them, funding is required to support their growth ambitions. Accordingly, their capital need will be larger, typically above EUR 1 million.

The majority of the portfolio will consist of young start-ups, since they are more affected by the current funding gap and offer the stronger lever to advance market development and thus social impact. Mature start-ups will be supported only in specific cases, often as a co-investment with other investors due to the larger ticket size. Start-ups with hybrid business models will be prevalent in the portfolio, because it is the dominant business model of young social enterprises.

Exhibit 6

The fund will focus on young start-ups, most of them with hybrid business models



The support provided: Funding with mezzanine capital or equity, together with coaching in business development

It is vital for the success of the portfolio companies that they receive both financial and non-financial support. Financial support will typically come through mezzanine capital or equity over a duration of five to six years. The nonfinancial support will typically focus on the business development as well as the measurement of the social impact.

Mezzanine capital will be the main type of investment for the hybrid start-ups. The investment will be made by means of a loan that is repaid in the final years of the investment period. The fund will also receive yearly interest payments through fixed interest and a share of profits after the start-ups break even. The exact details will be individually adapted to the situation of each start-up. This investment structure has proven successful for social start-ups in recent years, as it meets the investor's requirements while not "suffocating" the start-up in the early years.

From an entrepreneur's perspective
"Access to financing over five years or so in the form of a loan to be repaid towards the end would have done wonders for our rollout. The success of our business model and the community impact we had early on would have made investors happy, too."

Equity, or loans that can be converted into equity, will be used to invest in start-ups with market-based business models. As is common for equity investments, there are no payments to the fund during the investment period, and the fund can realize revenues solely from exit. The most probable exit options are sale to or merger with a strategic partner and sale of stake to the owners or management team.

Nonfinancial assistance will be provided from preinvestment up to the point of exit, with different emphasis in each stage. Before the investment decision is made, candidates will receive support in sharpening their business and impact model and possibly identifying new revenue sources. The most important assistance will be given during the investment with the focus on further business development and meaningful impact measurement. Towards the exit the exit readiness and opportunities for follow-up funding will be evaluated with the start-up teams.

The measurement of the portfolio company's impact is important for two main reasons: Firstly, for social enterprises, financial returns and social impact are similarly important ("double bottom line"), and clear KPIs for both are linked to the investment contract. Secondly, a clear articulation of the fund's social impact to investors, grant providers, and also the public will be key for its overall success. Typically, social start-ups need significant assistance in this area. Initially, the challenge is to define their impact model and determine clear KPIs both on output and outcome. Later, support is required to measure and interpret the social impact in a pragmatic yet insightful way and derive strategic and operational consequences.

In total, a relatively high effort is required to screen and subsequently support the portfolio companies. This also leads to fund management costs that are higher than for the typical (commercial) VC fund. However, a large share of these costs are incurred to clarify and develop the impact model so that they can be attributed to achieving social impact and could therefore be potentially covered by philanthropic or public partners.

The investment opportunities: Tranches with different risk/return/impact profiles allow for attractive investment opportunities

The fund will have a multilayered capital structure that combines hybrid (i.e., philanthropic or public) capital with investment capital.

Exhibit 7

Multilayered fund structure

Risk/sub-ordination			
Lower risk	Investment capital	Senior tranche	Lower risk and modest returns Capital is secured by guarantees and junior tranche
		Junior tranche	Higher risks and higher returns than senior tranche Secured by guarantees
	Guarantees		Enable investments by reducing risk through guarantees
Higher risk	Grants		Enable investments by increasing the fund returns (e.g., covering cost)

Investment capital is subdivided into two tranches, junior and senior, that have different risk-return profiles. The junior tranche has higher risk and return expectations of 3 to 5 percent under the current fund design. In case of default, its investment capital will cover the losses not backed by the guarantees. The senior tranche investment capital, in contrast, will only be lost after guarantees and junior tranche capital have been fully depleted. In turn, it also has lower return expectation of 2 to 3 percent under the current fund design. The senior tranche will make up the majority of the investment capital. In the current design, the fund falls under the EuSEF regulations and thus would be open to semiprofessional and professional investors only, with a minimum investment size of EUR 100,000.

As introduced earlier, hybrid capital can take the form of guarantees and grants. Guarantees secure parts of the investment sum to cover possible losses from portfolio company defaults. This capital is not invested and will only be paid out in case of actual capital losses. Public authorities are key partners in providing guarantee capital and thus enabling the fund concept. Currently, the European Union offers an interesting guarantee program. It supports financial intermediaries that fund social start-ups by means of small debt financing investments (EaSI program). These guarantees reduce the risk to a moderate level for the investors. Grants would most likely benefit the fund in covering the comparatively high cost of management that is incurred because of the small ticket sizes and higher need for support in business development. However, as of today, no public grants are available for the proposed fund concept (which will hopefully change in the near future).

It is worth noting that the risk level of the fund can be expected to be considerably lower than that of classical early-stage investment funds for three reasons. First, the portfolio will show strong diversification, as small ticket sizes imply a very high number of portfolio companies, which are also spread across multiple sectors. Second, the nature of these sectors add to a high degree of independence from economic developments. Third, experience shows that social enterprises, especially with hybrid models, tend to have less risky and therefore more stable business models with lower default rates compared to start-ups in nonsocial areas.

The investors: Impact-oriented investors will be the main source of capital for the initial fund

Each layer in the capitalization structure attracts a different investor. The junior tranche has a particularly strong leverage effect for social impact and will thus most likely attract investors that want to have high impact and can afford to take higher risks. This is due to the fact that the junior tranche is subordinated, thereby reducing the risk for senior tranche investors. This makes the fund more attractive to senior investors thus increasing the total fund volume. Junior investors could be family offices and high-net-worth individuals, as well as foundations or possibly public authorities. The senior tranche will be most interesting for investors that seek social impact, but rely on low risks, such as foundations investing with endowment capital.

At the current stage, the fund’s investors are expected to be individuals interested in achieving social impact. As the market develops and a more supportive (regulatory) ecosystem is created, “finance-first” investors (e.g., institutional investors) become potential investors.

Road map to success

The fund can be implemented with the support of pioneering partners

With the strong need for financing of social start-ups, the increasing awareness from investors in impact investing, and the recent support programs from public agencies for hybrid funds – now is the time to implement the hybrid fund and unlock the growth potential of impact investing.

The fund can be implemented with the support of a small group of pioneering partners. This group of partners needs to be identified, including a fund management team, fund sponsors, and initial anchor investors.

04

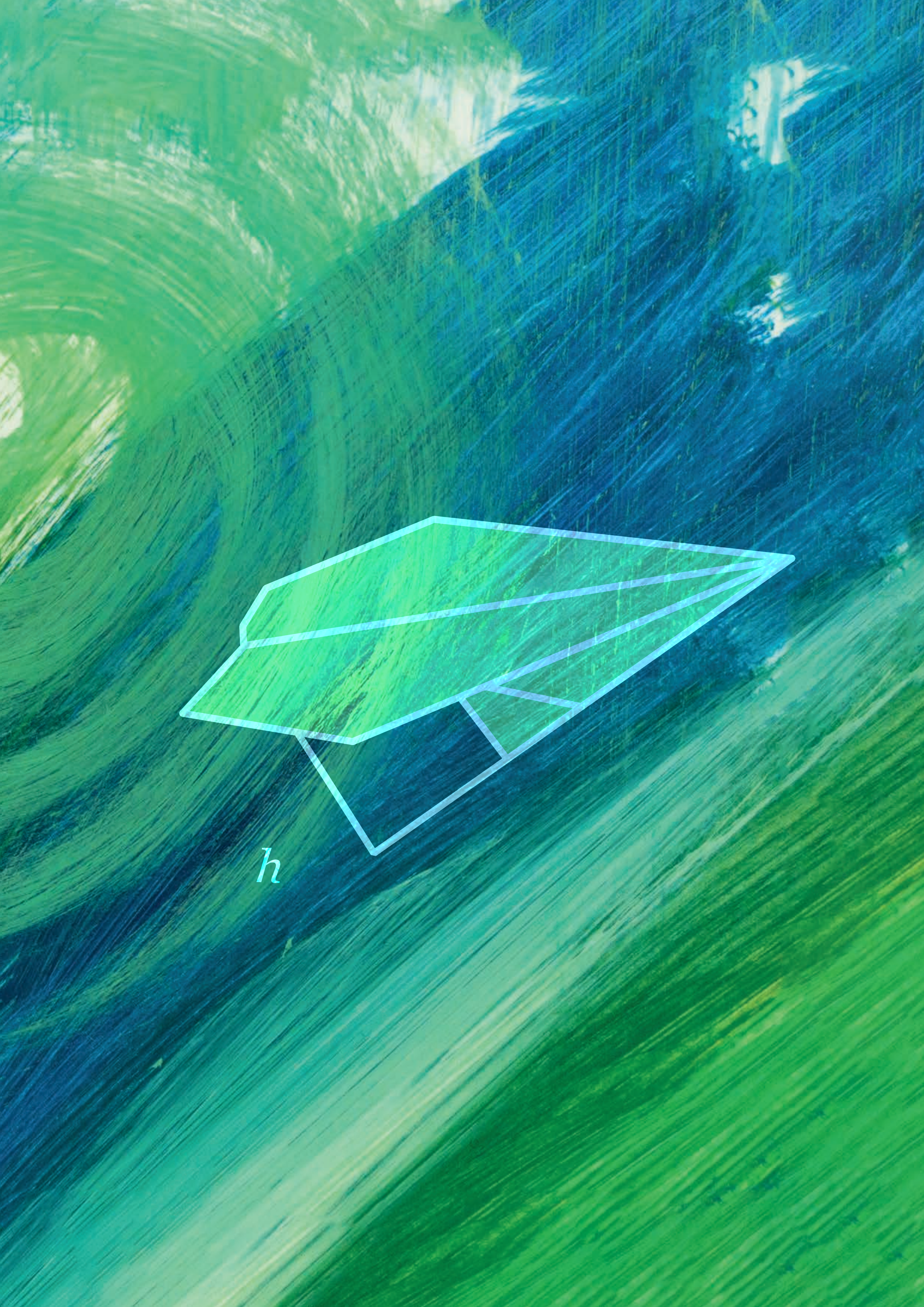
The fund management team will have the opportunity to shape the hybrid fund and spark the growth of impact investing. The fund management team will be key to implementing the fund concept and subsequently be the fund's operating force during its lifetime. It is essential that the management team not only has the financial expertise, but also can build on a strong reputation and successful track record of social investments in the social sector in order to build the required trust with the investors. The fund could be implemented either by an existing social organization in the social sector, by commercial fund management organizations, or a new team could be established. In any case, the backing and support of experts from the social sector will be important, e.g., through an advisory board and an investment board.

Fund sponsors will have the opportunity to establish a position as pioneers in impact investing by supporting the fund with the credibility/reputation of their name and potentially support the fund implementation either with grants or other forms of support. Foundations already active in impact investing could be candidates for this role.

Anchor investors can leverage their capital to attract further investors and thereby position themselves as leaders among impact-oriented investors. From the fund's perspective, anchor investors are required to build trust among other investors. Potential anchor investors could be, for example, foundations, private banks, and high-net-worth individuals.

Once these key supporters have been found, fund implementation can begin. In that phase, a small fund management team will set up the fund and its processes, register the fund, and apply for public support programs (e.g., guarantees). In parallel, further investors should be approached.

Finally, as the fund implementation comes close to completion, initial investment capital of EUR 5 to 10 million should be closed – with the aim to shore up the fund in the six to twelve months following. The fund management team can then be expanded step by step while the fund portfolio grows.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05

Planting the seeds

The fund for scaling start-ups can have a multiplying effect on the growth of the impact investing market

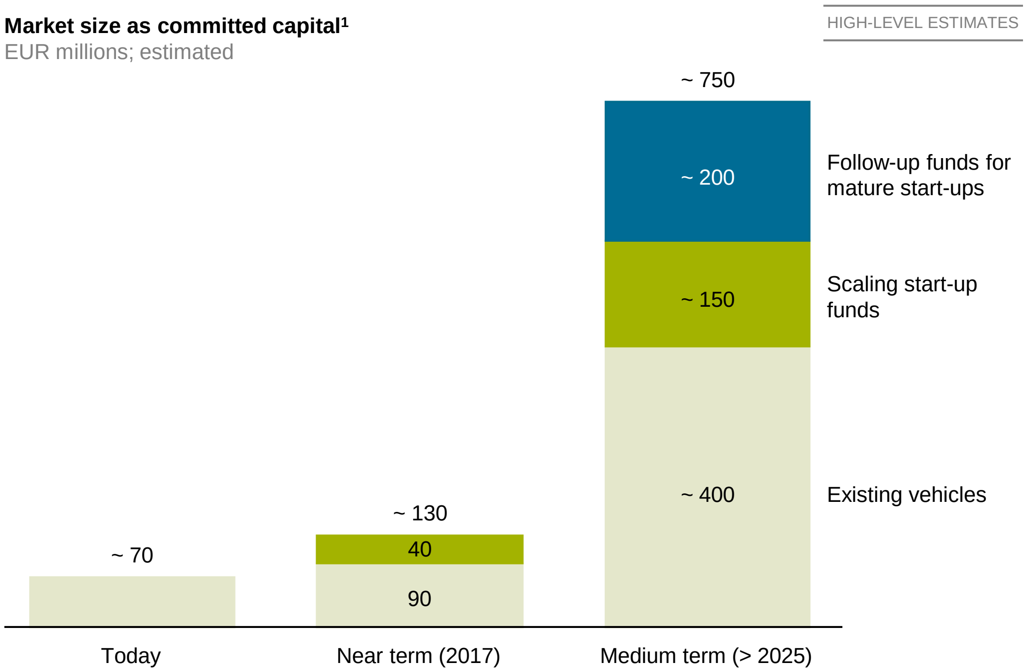
Implementing the fund has the potential to kick-start significant growth of the impact investing market, well beyond the scope of the initial fund. The initial fund, as elaborated upon above, bundles investment capital with its hybrid structure and focuses on small scaling start-ups. While the direct effect of closing the funding gap has been emphasized so far, realizing the hybrid fund has the potential to unleash even more substantial developments over the next 10 to 15 years.

In the near term, once the fund has proven to be successful, it can further increase investor and public awareness of the possibilities and the potential of impact investing. Thereby, investor demand for impact investments can rise and improve the opportunities of public support programs and fund capitalization.

Looking at a medium-term horizon, a successful initial hybrid fund can induce the setup of additional funds that target small scaling start-ups. Through both the initial and additional funds, the growth of a significant number of small start-ups will be supported, facilitating wider reach and greater impact. A share of these start-ups will be able to further grow their social business, forming a considerable new group of investable targets for later-stage impact investing funds. This will, on the one hand, fuel the growth of existing vehicles, and, on the other hand, potentially inspire the setup of additional vehicles to support later-stage growth.

Exhibit 8

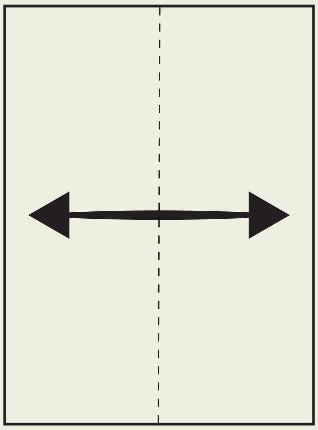
Initial hybrid fund could unlock significant potential in the German impact investing market – medium-term ambition level of several hundred million EURs



1 Actual assets under management (AuM) smaller than committed capital, since fund investments are distributed across 3 - 6 years; near-term EUR 50 million for existing and EUR 10 million for hybrid fund; medium-term approximately EUR 140 million for existing, EUR 80 million for hybrid fund, EUR 70 million for mature start-up fund

Over time, these processes could even accelerate. With an increasing number of investment vehicles, investors, and investable targets, the impact investing ecosystem would strengthen, and the remaining barriers would likely start to fall away. With additional funds, an increased pipeline of social start-ups, and an improved ecosystem, the market, for example in Germany, is estimated to grow from EUR 70 million today to EUR 600 to 800 million within the next 10 to 15 years. This type of growth would be a huge step in the direction of a financial market that channels investment capital towards good causes and spurs the growth of innovative social ideas. It would also lay the groundwork to transform the idea of "earning *to* give" into one of "earning *and* giving."

Ready for departure!
Are you?



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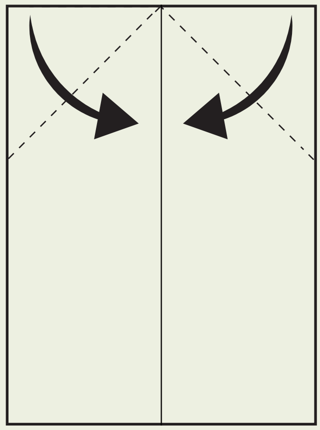

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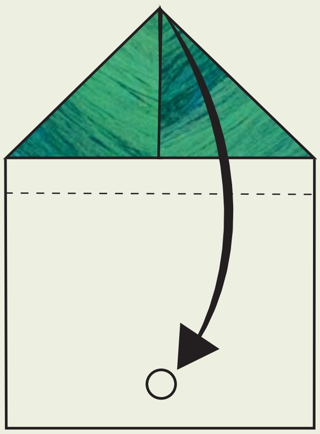

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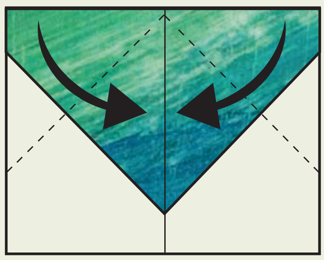

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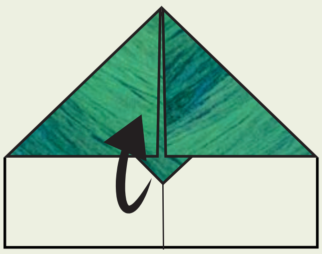

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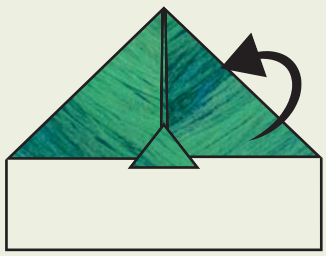

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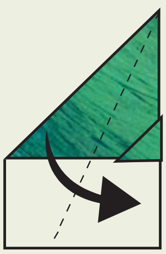

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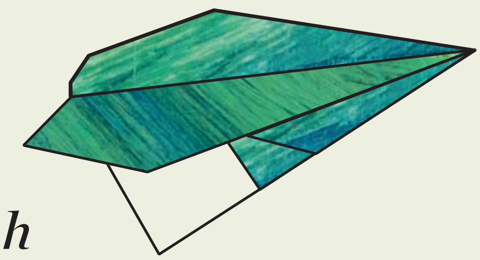

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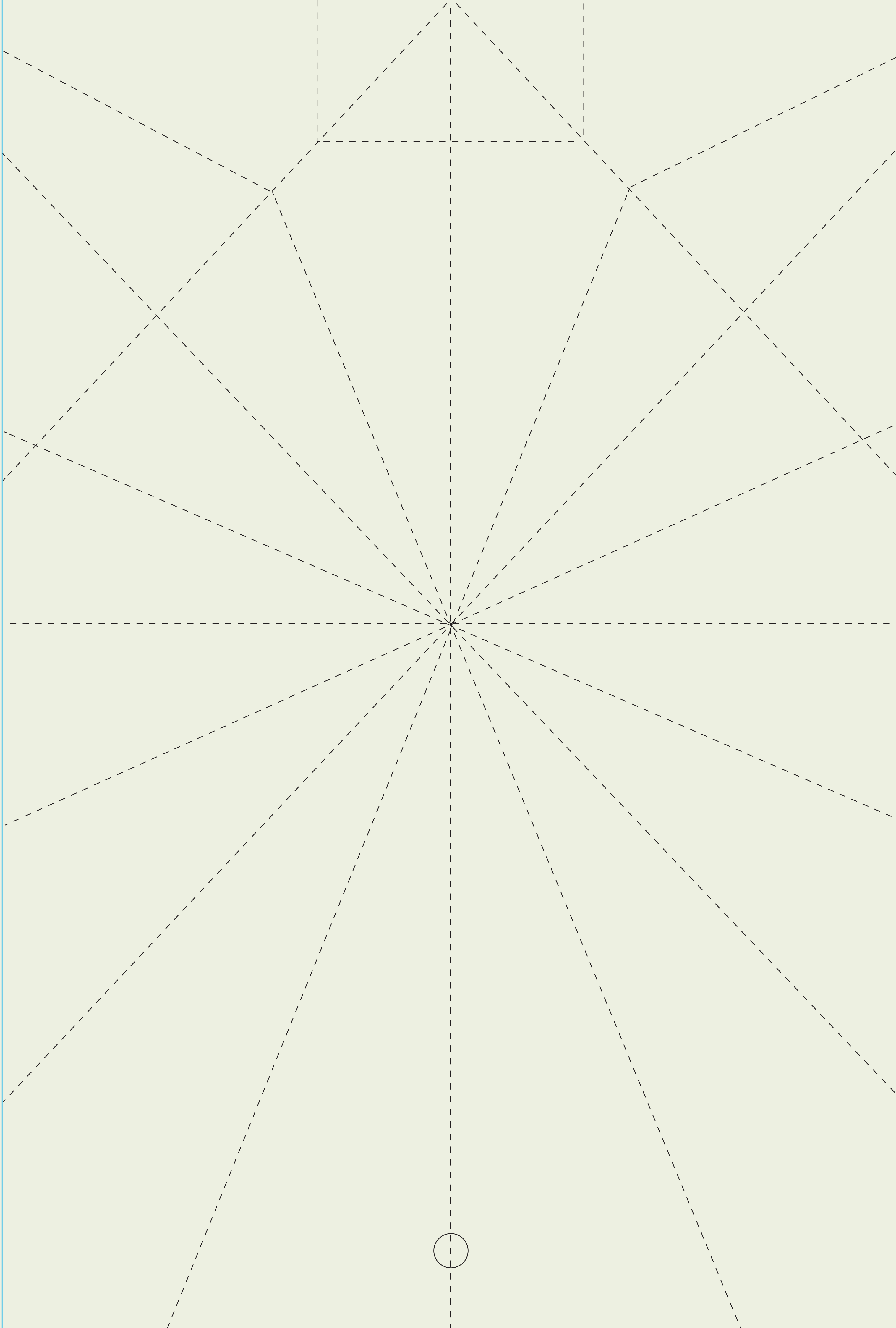


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BMW Stiftung Herbert Quandt
Amiraplatz 3 | 80333 München | http://www.bmw-stiftung.de

McKinsey & Company, Inc.
Kennedydamm 24 | 40027 Düsseldorf | http://www.mckinsey.com

Key contacts

FASE – Finanzierungsagentur für Social Entrepreneurship
Dr. Markus Freiburg (mfreiburg@fa-se.de)

Ashoka Deutschland
Rainer Höll (rhoell@ashoka.org)

BMW Stiftung Herbert Quandt
Carl-August Graf v. Kospoth (carl-august.kospoth@bmw-stiftung.de)

McKinsey & Company
Dr. Matthias Daub (matthias_daub@mckinsey.com)

Contact for foundation-related inquiries

Bundesverband Deutscher Stiftungen
Felix Oldenburg (felix.oldenburg@stiftungen.org)

Thank you

The report is the result of a collaboration between FASE, Ashoka Deutschland, BMW Stiftung Herbert Quandt, and McKinsey & Company. Its underlying analysis builds on interviews with 50 leading experts, including senior professionals from foundations, the public sector, asset management units, financial intermediaries, social businesses, specialized consulting firms, and many more. The publishers thank these experts for their invaluable contributions.

Supporting team

Dr. Florian Brummer, McKinsey & Company
Dr. Sebastian Göke, McKinsey & Company
Cecilia Wörthmüller, McKinsey & Company

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