# "Funding hybrid organisations"

# The next step of venture philanthropy

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**Abstract**

Hybrid structures are the biggest innovation in terms of social purpose organisation structures. Venture Philanthropy has always been at the forefront of supporting social purposes organisations with a high engagement approach that focuses on tailoring the financial instruments used to support social purpose organisations, providing non-financial support and measuring and managing the societal impact. Through this research report we aim at unpacking the practice of hybrid finance, giving a structure to the myriad of research reports that have been produced on the topic. The report explores different ways in which social purpose organisations can access different type of funding, coming from different actors with a variety of risk/return and impact profiles. After mapping the existing needs of social purpose organisations, we look into how venture philanthropy organizations can support them and we give taxonomy for hybrid finance support mechanisms and structures. The report concludes with key challenges and lessons learnt and with some highlights for future research.

## 1. Introduction – the Venture Philanthropy Approach

Venture Philanthropy (VP) is a **high engagement** and **long term approach** to generating societal impact and developing societal solutions adopted by **Venture Philanthropy Organisations and Social Investors** (VP/SI organisations). Venture philanthropists adopt three core practices (*Figure 1*)[1]:

- **Tailored financing**: the use of a range of financing instruments (grant, debt, equity, and hybrid instruments) customised to the needs of organisations supported (**Social Purpose Organisations** – SPOs).
- **Organisational Support**: the offer of added value support services from VP/SI organisations to investees (SPOs) to strengthen the SPOs' organisational resilience and financial sustainability, by developing skills or improving structures and processes.
- **Impact measurement and management**: the practice to manage and control the process of creating social impact in order to maximise it.

[1] http://evpa.eu.com/about-us/what-is-venture-philanthropy


**Figure 1: The Venture Philanthropy Approach (Source: EVPA)**

Taking into account the three characteristics above, it is possible to define the actors who are inside or who are outside of the Venture Philanthropy tent in Europe. Adopting these practices is the most relevant aspect to be considered a VP practitioner, even more important than the financing instruments used or the type of organisations supported (Buckland et al.).

Venture philanthropy works to build stronger investee organisations by providing them with both financial and non-financial support (including organisational support and impact management) in order to increase their societal impact. EVPA purposely uses the word “societal” because the impact may be social, environmental, medical or cultural. The venture philanthropy approach includes the use of the entire spectrum of financing instruments (grants, equity, debt and hybrid instruments), and pays particular attention to the ultimate objective of achieving societal impact and developing societal solutions. The investee organisations may be charities, social enterprises or socially driven commercial businesses, with the precise organisational form subject to country-specific legal and cultural norms. The EVPA spectrum presented in Figure 2 gives an overview of the types of investee organisations supported using the VP approach.

As shown in the spectrum, SPOs can take different forms, ranging from NGOs without trading revenues to NGOs with trading revenues and social enterprises and social businesses. For the purpose of this research we focus on SPOs that have the potential to become financially sustainable by generating revenues through a hybrid business model that combines the achievement of a sustainable societal impact with the generation of financial returns (e.g. **social enterprises**).

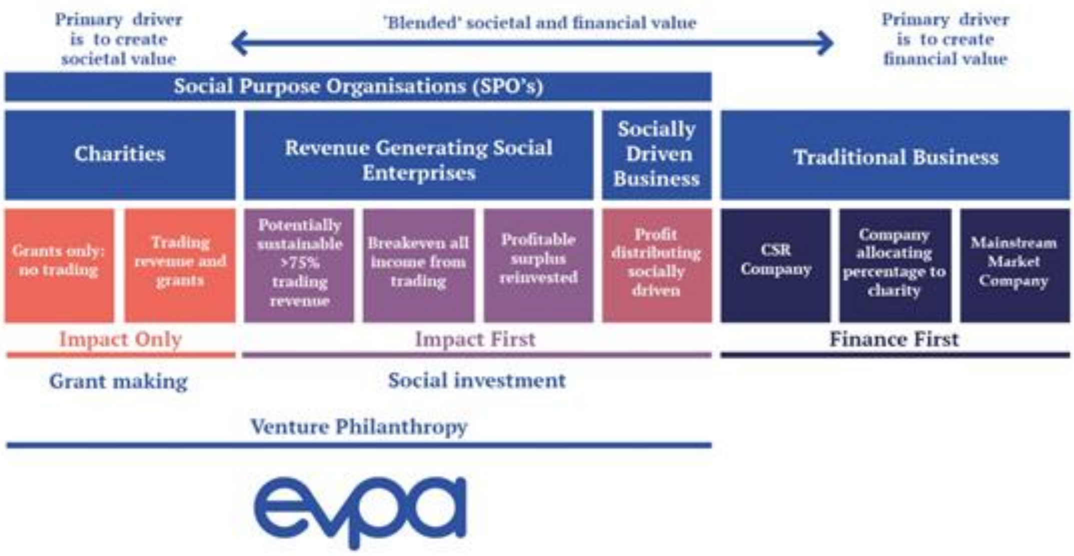


**Figure 2: The EVPA Spectrum (Source: EVPA)**

## 2. Reasons for the research

SPOs are organisations that operate with the primary aim of achieving **measurable social and/or environmental impact**. In order to grow at each stage of their development, SPOs need both financial and non-financial resources, which are adapted to their needs in a specific moment.

From the point of view of the VPO, finding **better** ways to **financially support social purpose organisations (SPOs)** and to **attract more resources into the VP/SI space** is crucial to strengthen the social impact these organisations can achieve. In the space in which SPOs operate, there is a pressing need to attract additional forms of capital and to bring in different expertise and perspectives.

As the association of venture philanthropy and social investment funders, EVPA is committed to help its members improve their VP/SI practices and the way they support SPOs develop, grow and scale, which is the first driver behind this research.

Another driver behind this research is the need to clarify a number of key concepts. In VP/SI there seems to be quite some confusion around the concept of hybrid finance. *Hybrid* seems a still vague notion, even in the existing literature: does it entail mixing different financing instruments to have societal impact? Is it about mixing public and private funds? Does it imply the creation of new hybrid structures and/or the signature of contracts to set up hybrid mechanisms? What is the difference between hybrid instruments and hybrid finance? All these questions need to be answered and concepts clarified.

Despite these issues, and the general confusion around the terminology, we see a growing interest in the VP/SI sector with respect to the opportunities of combining different financing instruments and different actors to invest and scale societal solutions.

We see the dilemma from both the social investors' side and the grant-makers' side:

- Grant-makers are concerned with who will scale up the successful SPOs they helped to start-up or develop. Additionally, they wonder about the preservation of the social mission of the SPO after the grant period ends.
- On their side, social investors are concerned with the quality of the solutions provided by the SPOs that they invest in. In the UK, for example, social investors report needing foundations to create a pipeline of investable SPOs by providing first-loss capital – by means of grants – that helps each SPO prove its model, before the social investor can step in and help scale through the provision of debt capital and equity. Similarly, in Germany, the Financing Agency for Social Entrepreneurship (FASE) is setting up a fund where foundations are putting financial resources to be used to invest in the earlier stage of new societal ventures, and social investors are putting capital that will be used to scale up the most effective ones.

As EVPA vision is to create a world where philanthropy and investment combine to drive sustainable societal impact, we strongly believe in the **collaboration of philanthropic capital and investment**, but we also see that for the moment they are often two separate worlds.
Hence we ask ourselves: which financing instruments are best suited to finance social innovations at different stages of development? How can different investors with different risk appetites and return expectations work together to sustain social innovation using a life cycle approach? How do you award the risk-takers who provide first-loss capital?

In this respect, we have seen that numerous reports have been published about the different structures/mechanisms that are set up to combine the risk/return and impact expectations of the different actors in the VP/SI space.. However, each report focuses on a particular mechanism or structure, and an **overview of all the opportunities that VP/SI organisations have to combine capital from different sources** is not available. Additionally, a summary about the **reasoning behind the use of these mechanisms/structures, the added value of this type of collaboration, and the common challenges and learning of these practices** is still missing.

Given all this, it is important to underline that this research is not a technical report on finance or financing instruments. It is not aimed at analysing in-depth all the different instruments, mechanisms and structures used and built up to support social purpose organisations. **This research is about impact and about how finance can be shaped in such a way that it is aligned with the purpose of the investee, and can help it generate impact, and how different actors in the VP/SI space can cooperate to leverage each other's resources.** From the **point of view of the SPO**, hybrid finance can represent an interesting solution to have available a mix of different resources to solve the existing funding gap that prevent them to get access to the capital needed. SPOs need different types of financial support at different stages of development but, since the diverse actors present in the VP/SI space often operate in isolation, there are many difficulties for SPOs to find the appropriate combination of funding to scale their social impact (DG EMPL European Commission, 2016).

**3. Methodology**

The study has been conducted building on the direct experience of VP/SI practitioners, and aims to offer an overview of the possibilities that venture philanthropy organisations and social investors have available to finance in an appropriate and innovative way SPOs.

We focus on the analysis of the **structures and mechanisms developed to address the financial gap in the funding available to SPOs**, engaging different actors and mobilising additional resources into the VP/SI space.

We started by scanning the literature on access to funding for social enterprises. We analysed the existing overviews of the financing instruments available in the VP/SI market, including hybrid financing instruments, the few reports on hybrid finance, and the researches dedicated to the specific hybrid mechanisms built up so far, from all available sources. We then developed a theoretical framework to summarise our findings and we reached out to the EVPA network to establish an expert group to solidly ground the research in practice. Our objectives in terms of the collaboration with the expert group were:

- to test the validity of our theoretical model;
- to work on the crystallisation of the definitions around hybrid finance;
- to look in-depth at how hybrid finance is happing in practice;
- to collect a series of cases on hybrid mechanisms and structures to identify their communalities and added value.

The 28 members of the expert group include VP/SI practitioners, academics, representatives of the European institutions and consultants, providing a key contribution to the development of this research.

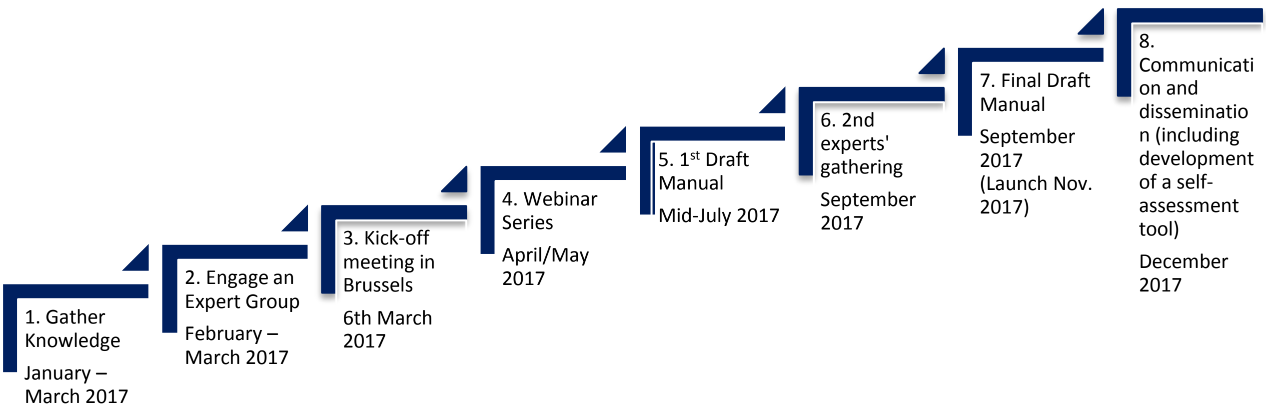


**Figure 3: EVPA research project timeline**

**4. Structure of the report**

We start by giving a definition of hybrid finance in section 5. Then, in section 6 we look at the characteristics of the SPO that help determine which is the most suitable financing instrument to use. In section 7, the possibilities that VP/SI organisations have available to support SPOs are summarised. In section 8, we provide a mapping of hybrid instruments, structures and mechanisms, with some examples. Whereas, in section 9 we focus on the challenges and learnings linked to hybrid finance. Lastly, some indications about future developments in the research are presented.

**5. What do we mean with hybrid finance?**

**Hybrid finance** is the allocation of financial resources to impact oriented deals, combining different types of financing instruments and investors.

Hence, there are two elements in hybrid finance:

1. The combination of **different financing instruments**, to create new tools to support social purpose organisations, the so-called **hybrid instruments**.
2. The combination of **different investors** into hybrid structures or through hybrid mechanisms:
    a. **Hybrid structures** are new investment vehicles set up with the goal of combining different risk, return and impact profiles of social investors. The purpose of the new vehicles is to collect capital from multiple sources, which can then be tailored to the needs of each investee. Often, these funds are managed by *financial intermediaries*.
    b. **Hybrid mechanisms** are contractual agreements that aim at attracting more resources towards impact-oriented deals, also by de-risking the investment of the low-risk-taker through private or philanthropic capital.

Thus, we should think at hybrid finance as the comprehensive space in which hybrid financing instruments represent a possibility for a VP/SI organisation to better match the needs of its investees, hybrid structures are ways that combine different actors to follow the same logic and try to reach the same objectives of financing hybrid instruments and hybrid mechanisms represent ways in which a VP/SI organisation can combine its resources with other actors in order to mobilise additional resources and generate an even greater societal impact.

The diagram below presents an overview of the different elements of hybrid finance.

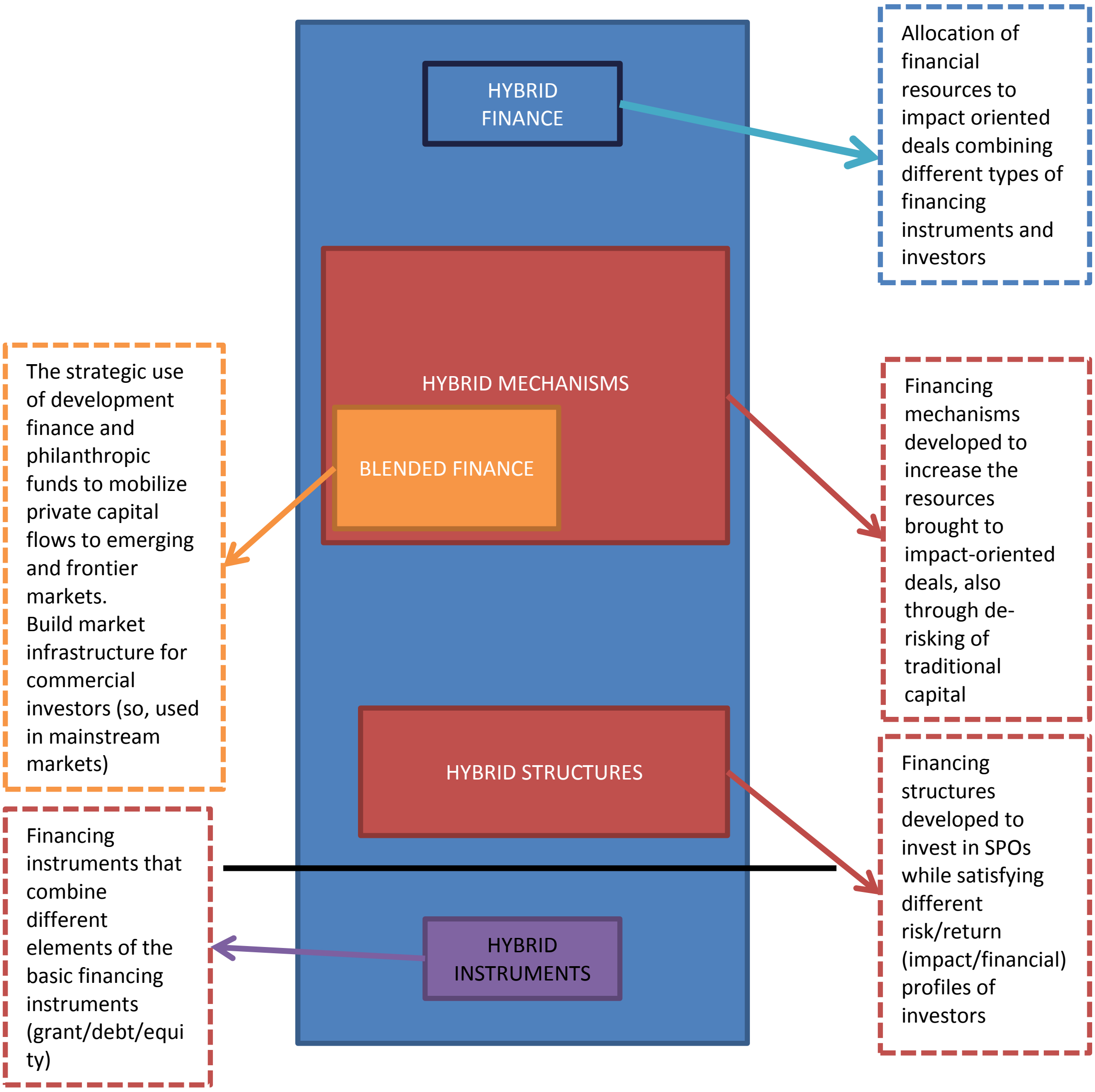


**Figure 4: Hybrid finance (Source: elaboration of EVPA's KC)**

We use the definitions outlined above throughout the paper.

## 6. The characteristics of the SPO that influence its financing needs

In this research we take an **SPO-centred approach**, since we believe it is important to focus on the needs of the investees. Every Social Purpose Organisation requires financial and non-financial support (Boiardi and Hehenberger, 2015) tailored to its needs to run its activities, to support its beneficiaries and – ultimately – to develop innovative and effective solutions that can solve specific societal challenges.

Social enterprises (SEs), the specific type of SPOs considered for this research, are organisations that can tackles social problems in creative, flexible, innovative ways and through fast approaches (Freiburg, M. et al., 2016). However, SEs often find it difficult to attract capital and receiving the appropriate source and mix of funding, to properly developed social solutions. The problem in the VP/SI market is not the lack of resources

available for social enterprises, but the capability of these SPOs to access the right funding at the right moment, and to be investment ready.
For instance, SEs might not fit many predefined funding criteria, they might lack internal capacity to become self-sustainable and, due to their size, they might need relatively small financing amounts, which translate in high transaction costs for financial intermediaries (EC and OECD, 2017).
Additionally, there is a general lack of understanding of the risks and the returns linked to investments to social enterprises. Regulatory obstacles, together with a lack of incentives for investing in SEs (ibid.), prevent a large portion of investors from supporting these early-stage social ventures.

In order to overcome these hurdles, there is the need to build a more efficient matchmaking between the resources available in the VP/SI space and the SPOs that need financing.

Based on our research, this allocation of resources is based on two factors: the business model and business structure of the SPO and its stage of development in the life cycle.

### *6.1. Business model and business structure*

Social enterprises act in a space that bridges traditional philanthropy and commercial markets. As such, SEs have a dual objective of achieving a sustainable societal impact and financial sustainability, making them **hybrids**.

This **duality of the business model** has important consequences on the **business structure** of the SE, as more and more SEs are not structured as pure for-profit **or** not-for-profit businesses, but as hybrid businesses (i.e. as a combination of for-profit **and** not-for-profit). Many social enterprises, facing the challenge of blending commercial and not commercial activities, often set themselves up as hybrid structures that incorporate both for-profit and not-for-profit subsidiaries that work together. This split of work between the for-profit and the not-for-profit entities enables SPOs to attract both philanthropic capital in the form of grants, and social investments in the form of debt and equity, to be channelled accordingly into the right entity. Thus, philanthropic capital will be channelled to support the non-profit part of the business, while social investment will be used to invest in the for-profit activities. Due to their hybrid nature, SEs can have advantages in terms of their capacity to seek funding from diverse sources, such as venture philanthropy organisations, social investors, foundations, public funds and mainstream finance.

As social enterprises are engaged in social purpose activities, they may not promise the same financial returns, liquidity and growth opportunities that a conventional commercial business can offer. The **nature of the business** SEs are engaged in and the type of clients and needs that they seek to serve have consequences on the attractiveness that they can have for traditional capital. Additionally, most SEs are engaging themselves in blended commercial and non-commercial activities, on one hand selling some products or services, while on the other hand having a strong social mission to pursue. In this way, the **financial returns might be lower**

compared to the ones realised by pure commercial businesses, **or might happen only after a longer period of time**. With lower and delayed returns to offer, social enterprises might not find traditional investors, they might not have any exit option in case of the deployment of equity and/or they would need longer time to pay back the capital received in case of a loan.
In these scenarios, SEs need to find both **patient and hybrid capital** to fund their work.

The combination of **the business structure** and the **nature of revenues** that the SE has will lead to some crucial issues: does the hybrid structure to be support have an ongoing need for subsidy via philanthropy? Does it always have negative financial returns? Will it continue to need also philanthropic capital alongside the social investment through the deployment of hybrid finance? In fact, sometimes philanthropic capital in the form of grants comes first, followed then by the deployment of FIs such as debt and equity or a combination of both, also in the form of hybrid financing instruments. Nevertheless the philanthropic capital might come alongside the social investment throughout the SPO's activity, due to a continuous need also for subsidy to run the part of its structure that will never generate financial returns.

### *6.2. Stages in the life cycle*

In an extended period of time, SEs go through sequential stages of development, starting from an early stage then becoming mature and – in successful cases – ready to be scaled. Throughout all these different phases, SEs change their funding needs, developing in some cases an appetite for more sophisticate FIs or diverse typologies of FIs, going from a need of philanthropic capital that doesn't foresee a repayment, to any kind of investment that expects capital to be repaid and/or a financial return to be paid back.

This sequence of phases is similar to the one experienced by start-ups acting in traditional commercial markets, and funded through Venture Capital and Private Equity, despite the clear differences that social enterprises present compared to traditional commercial companies.  And as in VC/PE, also in the VP/SI market, for each stage of development there is a different funding need that grows over time.

*Table 1* below summarizes the capital needs and the financing instruments available in each of the four phases of development of a social enterprise. However, **this sequence is not necessarily always linear**: it can be that a social enterprise, with a very volatile structure, is able to reach the break-even during the first year of activity, being able to attract capital that foresees a re-payment of capital or the generation of a financial return (e.g. debt and equity). Then, in the following year, the SE might not be able to achieve the same result, and would thus need to go back to philanthropic capital as a source of funding.

**Table 1: Different stages of development and financing needs (Source: EVPA's KC)**

| Stage of development | Description | Capital needed | Sources of capital | Financing instruments/ Hybrid Mechanisms |
|---|---|---|---|---|
| ***Start-Up Phase*** | The SPO has an idea, but not yet a full business plan.<br>The products and services are not yet saleable on the market and the SE is not generating any revenues by itself.<br>As a result the SPO needs start-up patient capital, and highly engaged support. | € 10-50k mainly for start-up costs, including product development, testing, piloting, business model development. | Families, friends and philanthropic funders. | Donations and grants<br>Sometimes debt and equity |
| ***Validation Stage*** | The product/service is launched into the market. | € 50k-€300k to test and prove the business model. | Families, friends and philanthropic funders<br>Social business angels | Grants and donations (also used in a strategic way, to mobilise in the form of guarantee or as pure leverage other funding such as loans to increase the working capital).<br>Equity |
| ***Preparation To Scale Phase*** | The business is growing and the social enterprise becomes able to also raise capital that foresees a repayment or a financial return. | More than € 300k to professionalise SPO's processes and functions. | Social impact investors | Equity and hybrid financing instruments (e.g. convertible loans, recoverable grants) |
| ***Scaling Phase*** | The social enterprise is ready to scale but not necessarily continuing to growth in its size but instead scaling the social impact it generates. | More than € 500k for the creation of codified practices that can be replicated by other SPOs, lowering the costs through franchising activities and replication models. | Social impact investors | Equity<br>Outcome s based mechanisms (e.g. SIBs) |

**7. Supporting social enterprises in suitable ways**

Given the different needs of the SPOs, there are **multiple possibilities for VP/SI organisations to act**.

If the venture philanthropy organisation/social investor can only use a single type of financing instruments (i), due, for example, to its legal structure, it would be appropriate to do a deal screening that takes into account whether the targeted social enterprises really need the financing instrument available, or whether it would be more convenient for the SPO to look for other types of financing. When the VP/SI organisation has the possibility to pick among a wider range of FIs (ii), it would be advisable to do an evaluation of the usefulness of each FI used to support a specific investee. The objective of this exercise is to understand the best way of supporting SPOs, also identifying hybrid financing instruments that, in their essence, can be a perfect mix of flexibility between different characteristics of the other main FIs.

In addition to these scenarios, a VP/SI organisation can decide to combine its capital with other actors interested in funding the same deal (e.g. setting up an hybrid structure or to defining an hybrid mechanism) (iii). One of the reasons for this can be that, in case the VP/SI organisation can only use a single type of FI, it needs to pull in other investors that use alternative financing instruments, in order to find an appropriate combination of FIs to support efficiently the investee. Another reason is that the VP/SI organisation sees the additionality brought in by the collaboration between different actors that put together not only diverse sources of capital, but also diverse skills, perspectives and experiences in deploying alternative financing instruments, in order to maximise the support given to investees and the impact potentially achieved.

## 8. A mapping of the existing possibilities within hybrid finance

In this section, we focus on the different possibilities to fund social enterprises through hybrid finance. Concretely, as described in section 5, we analyse **hybrid financing instruments** and **hybrid structures** and **mechanisms** that combine, in the same (or connected) transaction, **different actors**, with **different risk/return/impact profiles** to achieve specific impact-oriented goals that would not be achieved in isolation. Specifically, funding societal solutions that have not been addressed yet by single investors or that have not reached to appropriate scale.

### *8.1. Hybrid financing instruments*

Hybrid financing instruments are monetary contracts that combine features of the traditional FIs: grants, debt instruments and equity instruments. Looking at the three main categories identified: **grants** are a type of funding in the form of a cash allocation that does not establish rights to repayments or any other financial returns (Balbo et al., 2016). There are innovative forms and uses of grants that may incentivise the success of the exit plan (e.g. challenge grants). Atlantic Philanthropies includes requirements for matching support in its concluding grants, to help its investees replace Atlantic's funding where possible, and to adjust gradually to lower levels of support when a full replacement is not available (Proscio, 2014).

**Debt instruments** are loans that the VP/SI organisations can provide the SPO with, charging interest at or below market rates. The loan may carry a risk that exceeds what is usually acceptable for a commercial lender, or the normal commercial terms may be too onerous for the SPO. The interest charged varies also in relation to the securitisation and repayment priority of the loan (senior vs subordinated loan). A variation to this instrument is a loan with a social performance-related interest rate. When certain defined social targets are met, a discount on the interest rate will apply. Or, if variable, the higher the social return, the lower the interest rate would be (Balbo et al., 2016).

Lastly, **equity instruments** are contracts though which a VP/SI organisations acquires part of an SPO's business. This can be appropriate when the prospect of a loan repayment is low or non-existent. It holds the possibility of a financial return in the form of dividend payments. In addition, it allows for the possibility of a transfer of ownership to other funders in the future (ibid.).

Thus, hybrid financing instruments bring together some aspect of these three mainstream FIs in order to achieve the best possible alignment of return, risk and impact for particular deals. Some examples are (Varga and Hayday, 2016): **mezzanine finance** that **"***generally refers to that layer of financing between senior debt and equity, filling the gap between the two. It can take the form of convertible debt, senior subordinated debt or private mezzanine securities, debt with warrants. It is typically used to fund growth, for owners to take* *money out of the business or to enable management to buy out owners for succession purposes. Enterprises need to be cash flow positive. When used in conjunction with senior debt, it reduces the amount of equity required. Traditional mezzanine investors are hold to-maturity investors, generally focused on cash flow lending. There are loans where the financial returns to the investor are calculated as a percentage of the future revenue streams of the investee. If these are not achieved, then a floor rate or possibly zero is paid to the investor. The return can also be capped"*.

**Convertible loans, convertible debts** are "*two different circumstances in which the loan may be converted into equity. First and foremost, it is a loan that has to be repaid. However, in one circumstance, because the lender is willing to vary the loan terms in the borrower's favour, the borrower gives the lender rights to exchange its creditor position for an ownership in the enterprise at a later date. In another, more challenging circumstance, a loan is converted into equity either because the borrower's regulator requires the intermediary to bolster its capital or upon the occurrence of a future funding round. It is particularly useful where the enterprise is so young that a valuation is not possible and an equity price cannot be set*".

**Recoverable grants**: "*the terms under which the grant can be recovered are agreed upon in advance between the social investor and the recipient, which can be an intermediary as well as a front line enterprise. Designed to focus the recipient on sustainability and reduced risk of grant dependence. Because the grant is recoverable and therefore capable of being returned to the investor, it may not attract beneficial tax treatment in the hands of the provider. Documentation can be complex. It has to be shown as a liability in the recipient's accounts*".

***8.2. Hybrid structures – setting up new vehicles to combine financing instruments in a more effective way***

**Hybrid funds** are structured to respond directly to the SPOs' need of diverse specific FIs due to their hybrid structure and/or due to their evolution through consequential stages of development. This type of vehicles combines in a new hybrid fund the risk/return/impact profiles of different types of actors, such as public funders, philanthropic funders and social investors so that the new vehicle has its own impact and financial goals and risk profile, which might differ from the ones of the actors that set up this structure.

Often these hybrid funds aim at supporting **early stage social enterprises**. Specifically, this type of SPOs has difficulties in accessing both philanthropic capital and social investments, for different reasons. Since donors are not seeking financial returns, they tend to support non-profit organisations that don't generate revenues. Whereas social investors, which are interested in financial returns alongside social impact, normally support SPOs that have a strong potential in generating revenues, thanks to business models already proven. These more mature SEs allow larger ticket sizes and could offer a higher profitability (Freiburg et al., 2016). Thus, early stage SEs have difficulties in finding a suitable source of capital with the risk of not being supported at all or not being served in the most appropriate way.

In Germany, the **Financing Agency for Social Entrepreneurship** (FASE)[2] has set up a hybrid fund to serve a specific segment of the VP/SI market: **early stage social enterprises**. The fund would provide moderate financial returns (i.e. 2% to 5% across different investment tranches). The volume foreseen for the fund is € 40 million to support about 100 social start-ups over 10 year period. **Mezzanine capital** and/or **equity** over a duration from 5 to 6 **years** will be the financing instruments deployed through the fund (Freiburg et al., 2016). The fund will have a multi-layered structure, which will combine hybrid capital: bringing philanthropic, public and social investment actors together.

**Phineo**[3], a non-profit corporation based in Germany and working as intermediary, is setting up a pilot of a hybrid fund. The so called "hybrid donor fund" will invest in 6/8 impact deals, bringing together foundations and social investors. The aim is to leverage social investments through the philanthropic capital with a ratio of 1:2, in order to mobilise around €2 billion into the VP/SI market. So far, Phineo is screening the SPOs to be supported through the fund and **FASE** is looking for social investors to match the donations.

### *8.3. Hybrid mechanisms – combining different actors to develop societal solutions*

As anticipated in section 5, hybrid mechanisms are contractual agreements that aim at attracting more resources towards impact-oriented deals. There are diverse typologies of mechanisms that can be set up and they involve different types of actors, function in various way and have specificities linked to their forms. However, we see a common goal behind them: finding solutions to address the financing gap that prevent SPOs to get access to the appropriate capital.

#### *8.3.1. Outcome-based mechanisms – de-risking investments to bring more resources in the VP/SI space*

A typical example of hybrid mechanisms are the **outcome-based mechanisms,** contracts through which societal challenges are tackled in an innovative way, by stimulating the efficiency of social investors to generate a greater social impact. Outcome-based mechanisms are contracts financed by risk-taking investors to de-risk the investment for other type of actors, such as public entities and philanthropic donors.

The focus is on impact: governments/public entities and philanthropic actors re-pay the investment made by the risk-taking investor, including a surplus, only once the innovative intervention has reached the pre-defined societal impact results. Concretely, this practice avoids outcomes-payers taking risks in case the interventions don't work or don't achieve the societal impact expected.

**Social Impact Bonds** (SIBs) are a typical example of outcome-based contracts between governments/public entities and social investors.

Social Impact Bonds enable federal, state, and local governments to partner with high-performing service providers by using private investment to develop, coordinate, or expand effective programs (Dear et al., 2016)

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[2] More info at: http://fa-se.de/en/

[3] More info at: https://www.phineo.org/english

**Duo for a Job**[4] is a Belgian SPOs that provides young migrants with mentorship from experienced workers. At the beginning of its activities, it was lacking a significant track record and therefore Belgian government agencies were reluctant to provide financing. In 2014, **KOIS Invest**[5] structured the first-ever SIB in Belgium. Social investors provide upfront financing to Duo for a Job (the service provider), thereby taking the social impact risk away from the government (Actiris – the public agency for professional reinsertion in the Brussels Capital Region). At the end of the project, Actiris re-pays social investors their investment, plus an interest according to the social impact achieved and assessed by an independent evaluator (the Observatoire Bruxellois de l'Emploi). Thanks to the SIB, Duo for a Job is able to develop and scale its mentoring program through increased financing, and to focus more on its social programs through the outsourcing of their quest for financing. Additionally, the social issue linked to integration and access to the job market for migrants has been tackled by an innovative social program in a more efficient way.

Another type of outcomes-based contracts are **Development Impact Bonds** (DIBs). These contracts work following the same logic of SIBs, but in this case, the outcome-payer is a philanthropic organisation. Hence, the difference between SIBs and DIBs comes from who ultimately pays for the social outcomes.[6] A DIB aims to prove the concept of outcome-based financing and create a systemic change in the **financing of development interventions** over time.

**Educate Girls**[7] aims at reducing the gender gap among children going to school in India. Additionally, they have to objective to increase learning outcomes in schools. To support Educate Girl as social investor, UBS Optimus Foundation took part in a DIB of three years (mid-2015 to mud-2018), together with Children's Investment Fund Foundation (CIFF), the outcome payer; and IDinsight, the independent evaluator. After the first year evaluation, results were really satisfactory: in year 1, approximately 40% of the initial investment was recouped.

A third type of outcomes-based contracts are **Social Success Notes** (SSN).[8] These mechanisms have been created by the Rockefeller Foundation and Yunus Social Business to addresses the investment gap for social enterprises and social businesses. The premium based on the outcome achieved that the donor pays, makes the transaction more viable for commercial oriented investors, thereby unlocking additional capital to be channelled towards the VP/SI market.

The difference between Social Success Notes with SIBs and DIBs is the involvement of commercial investors that provide the social business with concessionary loans (i.e. loan bearing no interest or a rate of interest that is below the average cost). Then, if the social outcomes are reached, the commercial investors receive a premium from a donor, which amounts to a competitive market rate return.

[4] More info at: http://www.duoforajob.be/en/home/
[5] More info at: https://www.koisinvest.com/
[6] More info at: http://www.instiglio.org/en/impact-bonds/
[7] More info at: http://www.educategirls.in/
[8] More info at: http://www.yunussb.com/blog/social-success-note/ and https://www.youtube.com/watch?v=nJ91CE0i1Jw

**Impact Water**[9] is the first player in Uganda to offer clean water integrated systems to schools, combined with maintenance and 18 months credit, and reaching more than 500k children. Since they provide the systems on credit, in order to grow, they need capital in advance. **Yunuss Social Business** (YSB) started providing Impact Water with concessionary loans (interest rates were lower than the market ones). Then, since Impact Water was not ready yet to pay back market returns, YSB set up a Social Success Note to help them to be also subsidised by an impact-payer that pay a surplus if the impact is achieved.

***8.3.2. Solidarity Schemes – involving retail capital to bring additional resources into the VP/SI space***

Solidarity-savings schemes have been successfully developed in France. Actually, over 1 million solidarity savers in France chose to place their reserves through three main solidarity-saving channels. These schemes have been developed to increase the resources going into the social investment market, engaging new actors (i.e. private investors) into a space in which they were not present before.

One example of solidarity mechanisms are the French **90/10 Solidary Funds.** Since 2008 they act as solidarity saving-scheme obliging companies with more than 50 employees to offer their staff the possibility to choose to dedicate min 5% and max 10% of its savings to eligible social enterprises. As of today, approximately €5 billion are invested in these social business/solidarity funds (« épargne solidaire »), with €1bn directly invested in social businesses.

Two relevant actors in France within 90/10 funds are **BNP Paribas** and the **Société d'Investissement France Active** (SIFA). BNP Paribas managed € 68m from solidarity-based investment. Whereas, SIFA collects each year an important amount coming from 90/10 Funds: they have partnerships with the main asset companies in France (including BNP Paribas), and they collect the "solidarity-based" part of the 90/10 Funds they managed. In 2016, they invested in more than 330.

**9. Challenges and Learnings**

Despite the high costs that are associated to setting up hybrid vehicles and hybrid deals, these are of high added value, have a real unique value proposition and bring in a broad range of advantages, bot for the VPO and the SPO.

We are seeing a lot of **valuable innovations** in financing for impact, with hybrid finance being the most interesting way to bridge the funding gap of high risk new venture that hold the promise for more impact and financial sustainability. What is most interesting is that hybrid finance combines **cleverly public, philanthropic and commercial financing sources** in impact deals, making transactions more efficient for all the parties involved.

From the VPO's perspective, the first added value of hybrid finance is the engagement of **new classes of actors**, such as commercial investors and public funders, which normally don't invest in the impact space.

[9] More info at: http://impactwater.org/

These new actors do not only bring more financial resources in the space, but also valuable assets and capabilities. For instance, thanks to hybrid finance, philanthropic capital can be used to de-risk investments in early-stage social ventures with a high potential of scaling and becoming sustainable, making them attractive for investors with specific venture capital expertise, who can take over after the first phase to scale the venture and bringing him to the mainstream commercial market. Hybrid financing models **align the interests** of actors in a transaction around impact goals. Concretely, by plugging in commercial investors with investors that have a strong focus on social impact in a hybrid deal, impact oriented goals are brought in. And that will shape the transaction by deploying commercial oriented finance into the VP/SI space that normally wouldn't be linked to impact in impact oriented deals and making the impact goals clearer, more visible and better managed across the transaction.

At the same time, hybrid finance can unlock **new pools of capital** from investors that already adopt a VP/SI approach and are already active and present in the sector. For example, grant-making foundations can diversify the types of organisations they invest in, by joining funds with different risk-return-impact profiles. A second advantage of the emergence of hybrid finance is the **specialisation of capital**. Often, investors with specific expertise in deploying loans are forced to provide also grants to cover a specific need of an investee.. This solution is sub-optimal for both the VPO and the SPO, as the former is using an instrument it has no strong expertise in, and the latter does not receive the best support available. By combining multiple actors' capital and expertise in the same deal, SPOs receive the best support available, while all the investors deepen their capabilities deploying a specific instrument, which is known as specialisation of capital.
A third advantage of hybrid finance is the increased efficiency in **sharing and allocating risks**. For example, public entities are not willing to take risks to fund innovative activities, but through a social impact bond model they can invest in solutions that have a potential to work and even to be scaled, without taking the risk upfront.

From an SPO's perspective, the added value of hybrid finance is the promotion of the **sustainability and the capacity of investees**. Thanks to the combination of philanthropic capital and social investment (e.g. grants combined with loans), it is possible to sustain specific capacity building elements through grants that could not be easily financed by the loan because they don't generate revenues. Moreover, in some cases, structuring a new vehicle can complement the financial deficit in the business model of the social enterprise. By financing that gap, the remaining part of the investment becomes amenable to commercial oriented investors, thereby unlocking new capital encouraging commercial investments and making the hybrid model of the SPO more sustainable over the long-term, promoting its economic viability.

Despite their usefulness and practical value, hybrid structures present a number of challenges, as they function as contracts and agreements that involve multiple actors.
First of all, it can be **time intensive to bring together multiple actors** that have different processes, ways of working and timeframes that. The more actors involved, also means the **higher the coordination and**

**transaction costs**. Second, setting up a structure implies the need to align objectives. However the private actor will often (but not always) seek to transfer its risk to the public or philanthropic actor to protect its risk adjusted return. Determining the appropriate use of each type of capital in this context and aligning it with social impact objectives can be challenging.

It can be difficult to determine **the right level of 'hybrid' in a structure** , both in terms of whether it is needed at all (so commercial capital is not crowded out) and, if it is needed, what each actor needs to do to balance the risk burden and promote the SPO's sustainability.

Last, hybrid structures can be complex especially with different actors' requirements. Thus, unless they are integrated and absorbed at the intermediary level, accessing finance will be more challenging for the SPO.

**10. Conclusions and Recommendations**

Hybrid finance constitutes the next best way to finance societal impact through collaboration of multiple actors in the ecosystem.

We believe that it is necessary to stimulate and promote the creation of more hybrid finance mechanisms and structures, which will contribute to a more efficient allocation of the capital available in the sector.

Through our research we have tried to systematize the existing knowledge on this topic, by creating a menu and by codifying the most widely used hybrid finance structures/mechanisms.

As next steps we will work on disseminating the learnings on the use of hybrid finance mechanisms in impact investment, focussing on the advantages and openly discussing the challenges.

However, more needs to be done by researchers, who can give a clear contribution in this new area of development of venture philanthropy.

We believe there are many more examples of hybrid finance than the ones discussed in this report. We believe there is a need to keep on monitoring these innovations, to understand what works and what doesn't in the VP/SI space.

As hybrid finance becomes mainstream, the added value that hybrid finance brings into the VP/SI space will need to be assessed, looking in detail at how social enterprises and the society in broader sense benefit from these innovations.

There is a key role for standardisation and codification to reduce transaction and learning costs. We believe there is a need for further research to determine which structures and mechanisms are more efficient.

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