evpa
INVESTING *FOR* IMPACT





THE INVESTING *FOR* IMPACT TOOLKIT

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ACKNOWLEDGEMENTS

This toolkit is based on the EVPA publication *"A Practical Guide to Venture Philanthropy and Social Impact Investment".* This report was first published in 2008 as a working paper, and then updated in 2010, 2016 and 2018. The investing *for* impact toolkit is, therefore, the fifth edition of this publication, and would have not been possible without all the experts and practitioners who participated in the continuous developments of the guide over the last decade.

In particular, EVPA is very grateful to the first authors of this Practical Guide: Luciano Balbo, Lisa Hehenberger, Deirdre Mortell and Pieter Oostlander.

EVPA is also thankful to Priscilla Boiardi, who contributed to updating the later versions of this report, and to Elena Vittone, who designed the first practical online tool based on this publication in 2016.

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THE INVESTING *FOR* IMPACT TOOLKIT

What is this toolkit and who is it for?

The Investing *for* Impact Toolkit aims to assist newcomers or early-stage investors *for* impact by providing an insight into 'what works' in the European impact ecosystem. It contains strategies and best practices for applying the venture philanthropy approach.

This is the fifth edition of a working paper that was first published in 2008. This edition incorporates the learnings from more than ten years of research performed by EVPA's Knowledge Centre.

Throughout the document, we display the different frameworks developed by EVPA, step by step. Specifically, we illustrate the frameworks of the three venture philanthropy practices (i.e. tailored financing, non-financial support and impact measurement and management) and for managing an exit strategy. The three venture philanthropy practices are introduced in the beginning of the document.

Special consideration is given to the EVPA Charter of Investors *for* Impact, a document that sets out the ten principles that define and drive investors *for* impact. We have mapped each principle of the charter across the toolkit to better help investors *for* impact embed the charter in their strategy and activities.

This document is a guide for investing *for* impact as well as a compilation of EVPA's research and resources. It incorporates mentions and links to the most relevant resources to look at in each section.

This document is divided into four parts. First, we outline the process of setting up an organisation investing *for* impact. Second, we look at how to define the investment strategy. Then, we dive into each step of the investment process. Finally, we look at the execution of the exit process.

To better navigate this toolkit and understand the jargon of the impact sector, consult our glossary of terms.

Venture philanthropy – main definitions

Venture philanthropy (VP) is a high-engagement and long-term approach through which an investor *for* impact supports a social purpose organisation (SPO) to help it maximise its societal[1] impact.

The main actors involved are investors *for* impact, social purpose organisations and final beneficiaries:

- Investors *for* impact can be highly-engaged grant-makers or social investors (e.g. foundations, social impact funds). They are willing to take risks that most other investors are not prepared to take in order to support SPOs' innovative solutions. They adopt the venture philanthropy approach to support SPOs maximising their social impact.

- Social purpose organisations (SPOs) can be, for example, social enterprises, NGOs or charities. They can be revenue-generating or not. They have a solution to solve a pressing social or environmental issue, but often need resources (e.g. funding, human resources, capacity building).

- The final beneficiaries are those benefitting from the SPO's services or products; e.g. minorities, people in poverty, people with disabilities, women, children, migrants, or the environment.

Investors *for* impact adopt the venture philanthropy approach by being highly-engaged and committed in the long term, applying three core practices to support the SPOs:

Tailored Financing (TF) –
VP core practice #1

Non-Financial Support (NFS) –
VP core practice #2

Impact Measurement & Management
(IMM) – VP core practice #3

1 EVPA purposely uses the term "social" for the sake of simplicity, but the accurate term would be "societal" because the impact may be social, environmental, medical or cultural.

The Charter of investors *for* impact

Investors *for* impact are driven by 10 principles included in the EVPA Charter, which defines the DNA of such capital providers.

To endorse the 10 principles, sign the Charter of investors for impact here!

Figure 1: The Charter of investors *for* impact

The 10 principles of the EVPA Charter of investors *for* impact (Figure 1) identify the distinctive characteristics that differentiate investors *for* impact from other capital providers that also aim at generating positive impact on society. Thus, the Charter helps investors *for* impact better describe how they drive social impact, at a time when the growing interest in the impact ecosystem of different types of investors is raising the need for transparency, integrity and clarity around the focus on impact.

Investors *for* impact aim to apply the 10 principles in practice and to integrate them into their strategies and activities. Thus, the Charter not only defines the uniqueness of investors *for* impact but also represents a way forward for them and for new organisations joining the impact ecosystem.

Each principle translates into three explanatory statements. Throughout this toolkit, the 10 principles and the explanatory statements are allocated in chapters in which they are particularly relevant, starting from principle 1 displayed below.

Apply the Charter of investors *for* impact – Principle 1

1.

...BE PROBLEM-FOCUSED AND SOLUTIONS-ORIENTED, INNOVATING THE WAY TO TACKLE SOCIETAL CHALLENGES

- Be primarily dedicated to mitigating or even fully eliminating societal challenges.
- Proactively look for solutions that address the root causes of societal issues.
- Be eager to find and support those solutions that have the potential to transform the way in which a societal problem is tackled.

The Impact Ecosystem Spectrum

In the report *"15 Years of Impact – Taking Stock and Looking Ahead"*, EVPA included the impact ecosystem spectrum displayed in Figure 2, which defines the position and the role of the different types of investors active within the impact space.

Between traditional grant-making and sustainable and responsible investing (SRI), EVPA identifies two main impact strategies: investing *for* impact and investing *with* impact.

Investors *for* impact apply the venture philanthropy approach by tailoring their financial offer, providing non-financial support, and measuring and managing social impact. These investors take the social purpose organisation (SPO)'s needs as the starting point, and reverse-engineer which financial instruments are the most appropriate to support them. They are willing to take risks that no one else can – or is prepared to – take. Investors *with* impact, on the other hand, need to guarantee a certain financial return on their investment alongside the intended positive impact they aim at generating. They take a limited level of risk, often investing in business models that have proven track records of both financial and impact performances.

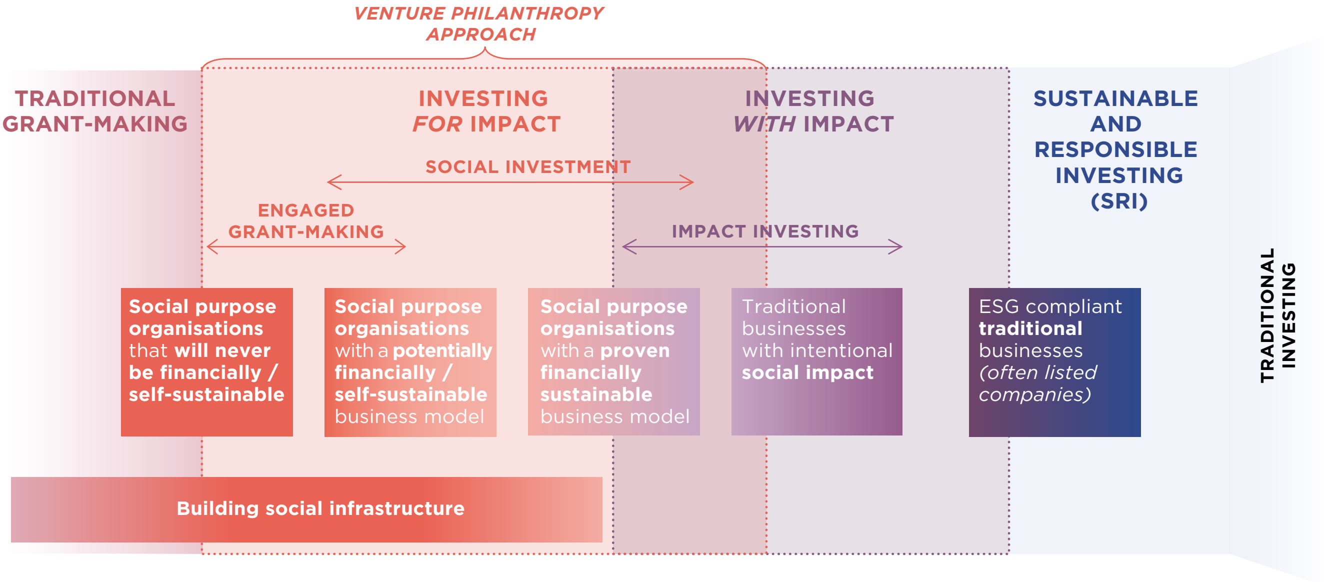

Figure 2: The EVPA Impact Ecosystem Spectrum

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Tailored financing – VP core practice #1

Tailored financing is the process of choosing the most suitable financial instrument(s) to support an SPO. These instruments include grant, debt/loan, equity, and hybrid financial instruments, such as mezzanine finance, convertible loans/debts, and recoverable/convertible grants. The choice of the financial instrument(s) depends on a number of factors, such as the investor *for* impact's financial/return expectations and willingness to take risk; the SPO's business model and stage of development; and the macro-environment in which the SPO operates.

In its report *"Financing for Social Impact – The key Role of Tailored Financing and Hybrid Finance"*, EVPA has developed a three-step process for tailored financing (see Figure 3).

Step 1 concerns the assessment of the pre-conditions of the investor *for* impact. In particular, two main elements of the investor *for* impact's strategy influence the choice of which financial instrument to use: its legal structure and its impact/financial return expectations and risk profile. Additional elements to consider are the investors/funders that support the investor *for* impact itself, the life cycle, the duration of commitment, the non-financial support provided and the team's expertise. The assessment of the pre-conditions of the investor *for* impact is part of the definition of its funding model and its investment strategy.

Step 2 is the assessment of the characteristics and the financial needs of the SPO. These include internal factors of the SPO, such as its business model, organisational structure and stage in the life cycle; and external factors, such as the macro-environment and the SPO's stakeholders. This step takes place during the deal screening and the due diligence phases of the investment process.

Finally, step 3 of tailored financing consists in matching the goals of the investor *for* impact with the needs of the SPO. Considering the results of steps 1 and 2, in this phase investors *for* impact consider whether to deploy grants, debt instruments, equity instruments or hybrid financial instruments to better match their goals with the SPO's needs. This step occurs during the investment decision and deal structuring phase of the investment process.

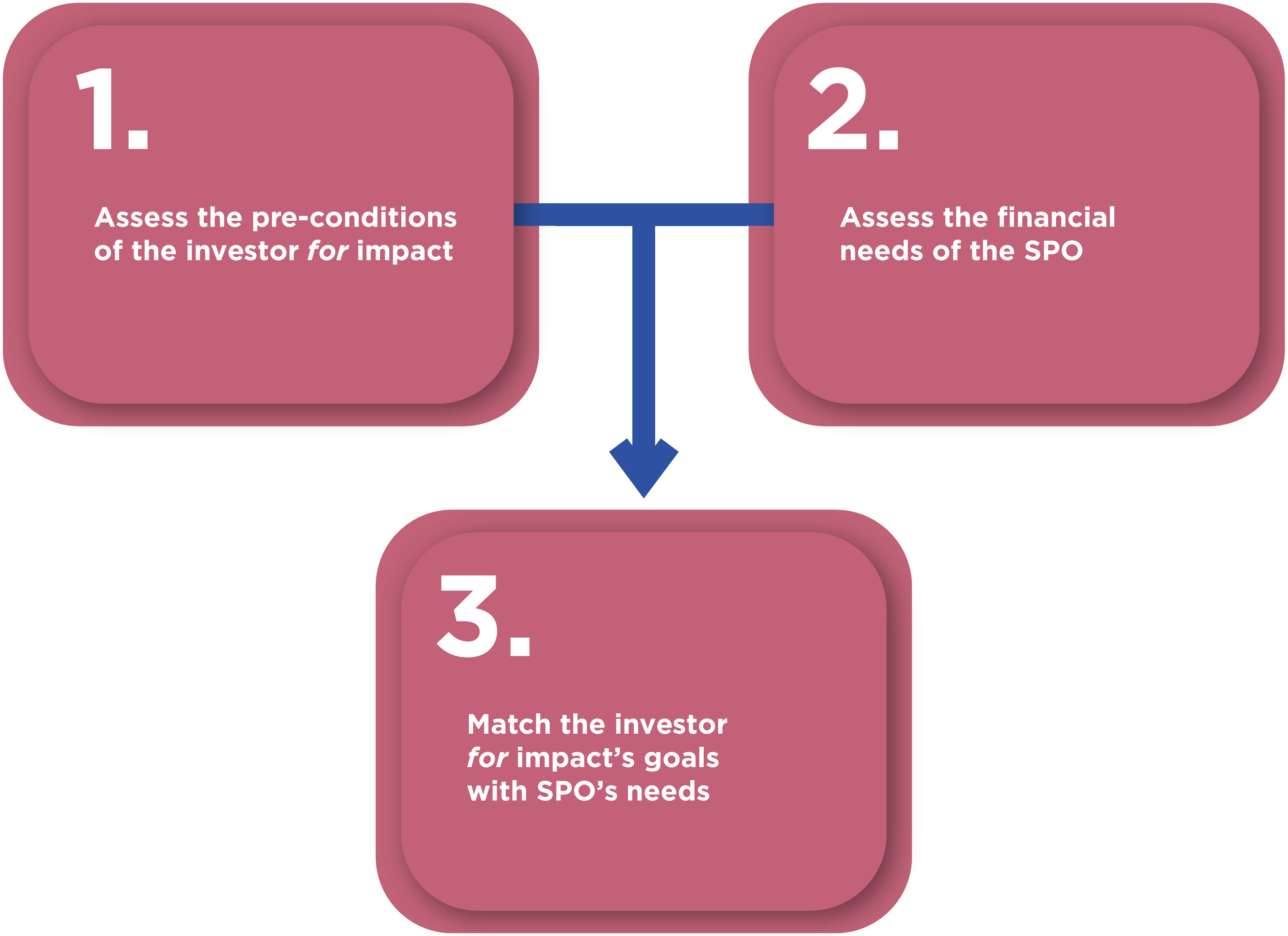


Figure 3: Three-step process of tailored financing

Non-financial support – VP core practice #2

Non-financial support (NFS) is the process of providing support services to a social purpose organisation in order to maximise its social impact, increase its financial sustainability or strengthen its organisational resilience.

There are different types of NFS, such as the development of a Theory of Change and an impact strategy; impact measurement; fundraising; revenue strategy management; financial management; governance; human capital, etc.

EVPA has developed a five-step framework, displayed in Figure 4, which is analysed in the report *“A Practical Guide to Adding Value Through Non-Financial Support”*. For each step in the process, an investor should consider how this relates to the day-to-day work of funding and building stronger social purpose organisations. That is why managing non-financial support is at the core of the NFS process. It occurs continuously and is facilitated by integrating NFS into the investment process.

In step 1 of the NFS process, investors *for* impact map their own assets. Based on their own impact objectives, investors *for* impact consider what types of NFS they have available to help the SPOs advance on the three core areas of development (i.e. social impact, financial sustainability and organisational resilience). This step is defined in the investment strategy.

Step 2 consists in assessing the needs of the SPO. A light assessment is made at the deal screening phase, and a further in-depth assessment is carried out during the due diligence.

Step 3 involves developing the non-financial support plan, which includes the baseline, the goals, the milestones and the target outcomes for the SPO. This plan is developed during the deal structuring.

The non-financial support delivery phase, i.e. step 4, is carried out during the investment management. Delivery modes of non-financial support can be taking a seat on the board of the investee; coaching the management team; organising trainings, workshops and boot camps; taking the SPO to external events and offering access to networks.

Finally, step 5 consists in assessing the value and impact of NFS, and it takes place during the post-exit evaluation, illustrated in part 4.2 of this toolkit.

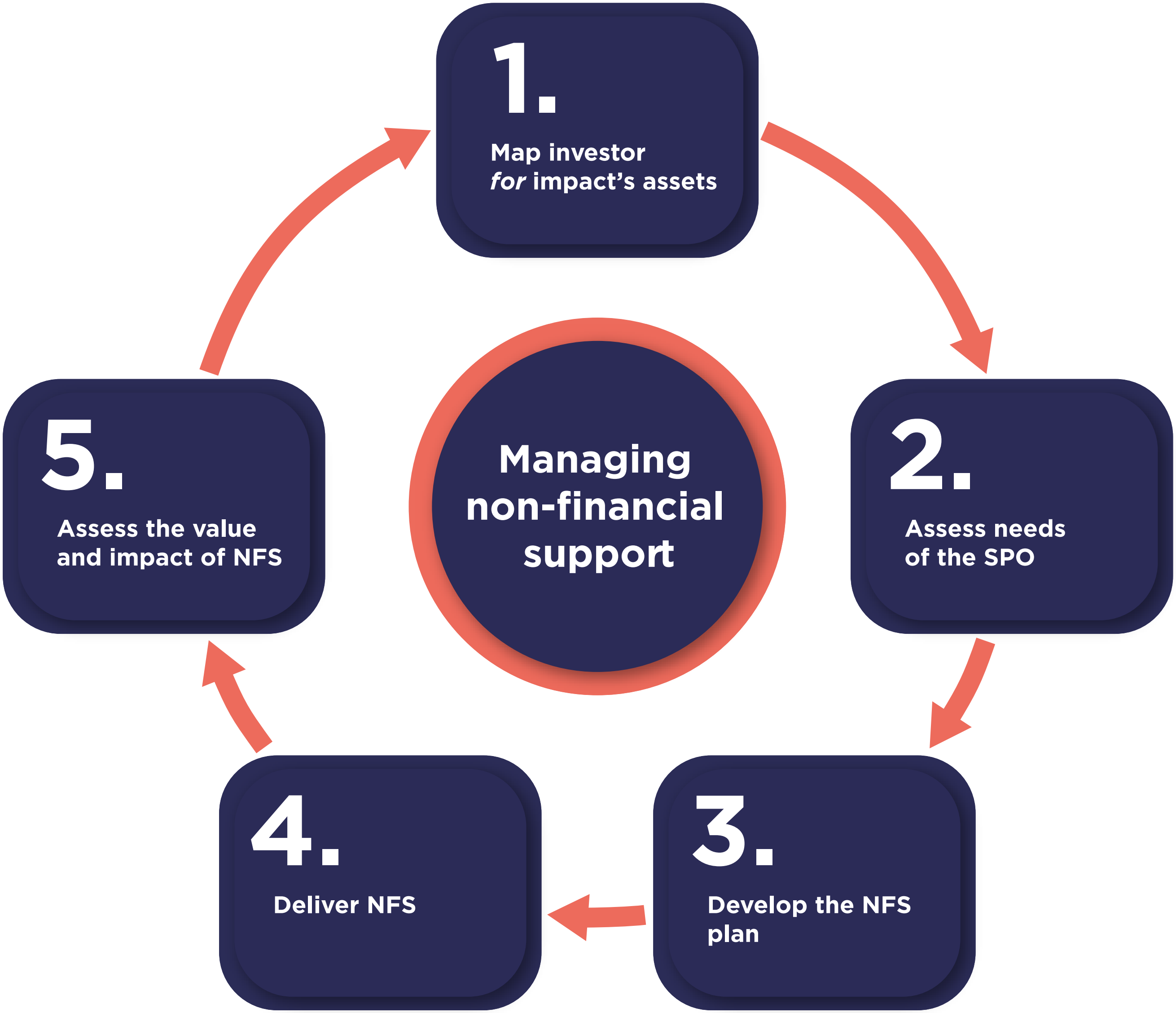


Figure 4: Five-step process of non-financial support

Impact measurement and management – VP core practice #3

In EVPA's definition, the impact measurement and management practice (IMM) is measuring and monitoring the change created by an organisation's activities, and using this information/data to refine activities in order to increase positive outcomes and reduce the potentially negative ones.

EVPA has developed a five-step approach to measuring and managing impact (Figure 5), which can be applied by both investors and investees, and which is presented in EVPA's *"Practical Guide to Measuring and Managing Impact"*. This framework has informed the European Standard for impact measurement and management developed by the European Commission's group of experts on social entrepreneurship *"Groupe d'experts de la Commission sur l'entrepreneuriat social – GECES"*.

This guide focuses on two levels: how to measure and manage the impact of specific investments (level of the SPO) and how the investor *for* impact itself contributes to that impact (level of the investor).

The EVPA impact measurement and management framework is a "circular process" which an organisation is supposed to go through more than once, to constantly improve its IMM system. The entire IMM process occurs during the investment management phase. However, before reaching an investment agreement, investor and investee should already go through the different steps of the framework and define the IMM strategy.

Step 1 consists in setting objectives. When defining the investment strategy, investors *for* impact should define their own impact objectives. Then, during the deal screening and, more in-depth, during the due diligence, investors should set long-term impact objectives together with the SPOs under scrutiny. Step 2 entails a stakeholder analysis and starts during the due diligence. During the deal structuring, investors define outputs, outcomes, and impact, and select indicators that can capture the SPO's progress towards or away from the intended outcomes, i.e. step 3. Step 4 consists in verifying and valuing the impact that has been generated. This is first performed in the course of the due diligence and repeated after the investment has exited, i.e. during the exit follow-up phase. Step 5, monitoring and reporting, is defined during the deal structuring: investors and investees decide how they will assess whether the progresses are in line with their objectives, and how they will report back to their stakeholders and the broader community. Step 5 is also repeated after the investment management (i.e. during the exit follow-up phase).

Figure 5: Five-step process of impact measurement and management

THE JOURNEY

I
Setting up an organisation investing *for* impact

1. Defining the funding model and the legal structure
   TF step 1
2. Developing a sustainable fundraising strategy
3. Recruiting a CEO and the management team
4. Working out the role of the board
5. Abiding by high ethical standards **10**

II
Investment Strategy

1. Defining how to measure and manage social impact **5**
   IMM step 1
2. Defining the social problems to tackle and applying appropriate strategies **4**
3. Defining the geographical focus
4. Defining which type(s) of social purpose organisations to support **2**
5. Selecting which financial instrument(s) to use to support which SPO(s) **7**
   TF step 1
6. Defining what non-financial support to offer **6**
   NFS step 1
7. Defining how to collaborate with other actors **8** **9**
8. Thinking about the exit already as part of the investment strategy
   Exit step 1

III Investment process

1. Deal screening
   TF step 2 | IMM step 1 | NFS step 2 | Exit step 1

2. Due diligence
   IMM steps 1, 2 and 4 | TF step 2 | NFS step 2 | Exit step 2

3. Investment decision and deal structuring
   IMM steps 3 and 5 | TF step 3 | NFS step 3 | Exit step 2

4. Investment management
   IMM – impact management | NFS step 4 | Exit step 3
   3

IV Exit

1. Exit management
   Exit step 4

2. Exit follow-up
   IMM steps 4 and 5 | NFS step 5 | Exit step 5

LEGEND

0 — Principle of the Charter of Investors *for* Impact

NFS step 5 — EVPA framework

I.

SETTING UP AN ORGANISATION INVESTING *FOR* IMPACT

Social Bee © Fotogenika

I. SETTING UP AN ORGANISATION INVESTING *FOR* IMPACT

An investor *for* impact should consider some issues when setting up an organisation investing *for* impact.

First, before setting up such an organisation, consideration should be given to the type of funding model that will be applied and the best legal structure to establish the funding model. Second, fundraising is a key challenge for any new investor *for* impact, so appropriate strategies should be applied. Third, the recruitment of the CEO and the management team will be critical to the success of the organisation. Fourth, the role of the board must be defined, as well as the tasks and duties of the board members. Finally, any new investor *for* impact needs to ensure that it keeps high ethical standards in the management of its activities.

CHECKLIST

- Defining the funding model and the legal structure
- Developing a sustainable fundraising strategy
- Recruiting a CEO and the Management Team
- Working out the role of the board
- Abiding by high ethical standards

1) Defining the funding model and the legal structure

How to start assessing the pre-conditions to provide financial support

Various types of instruments are available for funding social purpose organisations (SPOs), such as grants, debt, equity or hybrid financial instruments, which include mezzanine finance, convertible loans/debts, and recoverable/convertible grants. Before structuring an organisation investing *for* impact, the funding model to be applied should be defined, by assessing the pre-conditions of the investor *for* impact – i.e. step 1 of tailored financing. Three main elements will influence the choice of which financial instrument to use: the legal structure, the impact/return expectations, and the risk profile.

At this stage, a basic question to be answered is whether the organisation investing *for* impact will act as a social impact investor or focus on engaged grant-making. In many European countries, tax and legal regulations distinguish between grant-making and instruments that establish ownership titles. Grant-making can usually be done from organisations with a charitable status, whereas in various countries other types of funding could conflict with a charitable status, although the primary goal for those instruments is social when used by investors *for* impact. In many cases, the choice of financial instruments will impact the legal and tax structure of the investor *for* impact, and it is recommended to seek for specialist advice.

When the primary activity of the organisation investing *for* impact is to provide grants to SPOs, it tends to be set up as a foundation. Through grant-making, foundations can take high risks and support innovative solutions. If the investor *for* impact mainly invests in social enterprises through social investment (using a range of financial instruments), it is usually set up as an impact fund. Funds can be limited in time or evergreen, which means that they do not have a limited life.

As described in the report *"15 Years of Impact – Taking Stock and Looking Ahead"*, although impact funds and foundations are the early adopters of the venture philanthropy approach, more and more players are entering the impact space, playing strategic roles. These can be social investment crowdfunding platforms, financial institutions, the public sector, institutional investors, incubators and accelerators, asset managers, family offices, NGOs and development finance institutions.

Along with the funding model and the legal structure, social impact considerations are the main drivers of investors *for* impact. These are further analysed during the definition of the investment strategy.

Tailored financing

Alongside the legal structure and the impact strategy, there are other factors linked to the investor *for* impact that can have implications on the funding model:

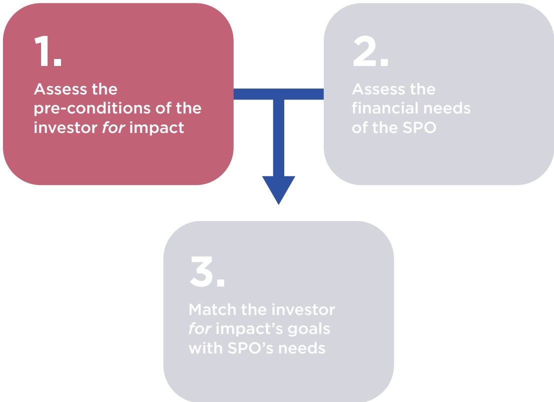


Figure 6: Step 1 of tailored financing

- The investors/funders' wishes in terms of what level of social impact and what level of financial returns (if any) should be achieved.
- The life cycle of the investor *for* impact (i.e. whether it has a self-liquidating structure, a perpetual life cycle or a "continuously fundraising" model).
- The duration of commitment, given by the length of time the investor *for* impact is willing to support an investee.
- The non-financial support that the organisation commits to providing to its investees.
- The expertise of the team and the skills of the employees in managing different types of financial instruments.

Resources

Report **"15 Years of Impact – Taking Stock and Looking Ahead"** (EVPA, 2019) – see Part 2

2) Developing a sustainable fundraising strategy

Sources and methodology for obtaining capital at the different stages of development of an organisation investing *for* impact

The nature of the founder affects the type of fundraising required. Some individual founders and institutions have been able to fully fund the investor *for* impact without external fundraising, others engage in formal fundraising from third parties and some use a combination of both. When the investor *for* impact is closely linked to a larger institution, funding is often provided on an ongoing basis by budgeting a certain amount to the investor *for* impact each year. However, in many cases, the investor *for* impact needs to engage in fundraising in order to operate and have money to invest.

Raising capital successfully from third parties requires:

- A *clear vision* of what is intended to be achieved with the capital.
- A *clear structure* and an investment strategy.
- *Credibility* and ability to deliver the vision.

The funding model can pose challenges, especially when it comes to the financial sustainability of those investors *for* impact that do not have an endowment and thus have to rely on fundraising to sustain their activities. Investing *for* impact needs 'patient capital' that is flexible enough to accommodate unforeseen circumstances.

Prospective donors and investors need clarity on the investor *for* impact's investment model and goals. The founder(s) needs to clearly articulate how the money will be invested; which areas will be prioritised; what the overall social impact will be; and how the organisation will manage to achieve its goals. It also needs to consider how the organisation investing *for* impact will sustain itself over time. The founder's personal track record will be critical.

In the social sector, the providers of capital are driven by a combination of heart and head. They will be motivated to support an organisation investing *for* impact by heart, considering the vision of the social good to be achieved; but they will also be strongly influenced by the head, looking at the plausibility of the plan and whether the agreed objectives are likely to be achieved.

Potential sources of funding:

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

- *Trusts and foundations* generally make smaller grants to support projects. Promoting innovation can be an important motivation for these organisations, and they are thus likely to support the first fund in a particular geographical area.

- *Corporate sources* are an important source of capital, usually for corporate social investors, which are becoming more and more engaged in the impact ecosystem.

- *High-net-worth individuals* can sometimes be accessed through private banks. An investor *for* impact can get in contact with the bank's philanthropic advisors to build a long-term relationship. Offering the opportunity to invest *for* impact can be a value-added service that banks offer to their clients.

- *Government agencies* sometimes support efforts of this nature, in order to foster new ideas and develop the social market. However, this relationship might entail a very long sales process and significant operating restrictions. In most cases, other investors will be needed to support the effort and to give the plan more credibility and independence.

Inspire2Care – Karuna Foundation © Leonard Fäustle

Start-up funding

Raising the initial capital is clearly difficult, but it helps if the founder(s) can commit some of its/their own resources to cover both capital needs and operating costs. This not only helps financially but also demonstrates their commitment to the project.

Educating the potential supporters about both the methods and the benefits of investing *for* impact is essential. The first step in that direction is to clearly articulate a Theory of Change, as outlined in part 2.1 (see pages 39-42). Potential supporters may be wary about investing in a blind pool – i.e. committing capital to a fund whose investment targets have not been identified. Hence, it may be necessary to pre-select five or six candidate organisations to support before starting the fundraising.

Finally, the investor *for* impact may need to demonstrate the organisation's capability by putting in place an initial management team before raising funds. In the absence of a major early-stage sponsor, the organisation will necessarily grow slowly, starting with just a few people and expanding as it starts to build a track record.

Key issues to consider before attempting raising a first-time fund:

- *Being clear about objectives* and trying to articulate a Theory of Change.
- *Carefully targeting potential investors* and developing an understanding of why they would want to support the organisation investing *for* impact – remembering that each potential supporter will have different motivations.
- *Anticipating the difficult questions* and thinking about how to respond credibly.
- *Finding an early-stage lead sponsor* – seeing if identifying a foundation, a financial institution, high-net-worth individuals or other entities with a strong funding base. This will give more capital and more credibility while developing operations.
- *Being prepared for a major effort*: the majority of the people contacted will say no, and it will be necessary to learn from those rejections and to adjust the approach as necessary.
- *Being optimistic and persistent*.

Follow-on funds

Follow-on funds ideally should not be raised until several years after start-up, so that the investor *for* impact can point to the results achieved with the prior fund(s). The advantage of raising a follow-on fund is that there should be an established team, an established portfolio of investments, and some evidence to support the claim that the intervention has made a positive impact. The fundraising pitch can be based on the track records developed and on the progress that has been attained and should facilitate the fundraising process.

However, moving from the start-up to the follow-on phase can be difficult. Some supporters will be more animated by the excitement of a start-up and the opportunity to invest in a new concept. Moreover, founders may have exhausted the appetite of their immediate network and may have to start 'cold-calling'.

The profile of investors for the second or third time round is broadly similar to that of the funders initially targeted, but depending on the strength of the investment case, they may offer a better reception. For example, institutional investors will be difficult to attract in the start-up stage, but it may make sense to bring them in for a follow-on fund. However, as highlighted in EVPA's report *"Learning from Failures in Venture Philanthropy and Social Investment"*, institutional investors tend to still be more focused on achieving high financial returns, sometimes to the detriment of social impact.

Key issues to consider for follow-on fundraising:

- *Using case studies from the portfolio* where added value delivered and the social benefit achieved can be demonstrated clearly. It is important to be careful that claims are not exaggerated and they can be substantiated.

- *Refining the targeting strategy*. There may be subgroups of potential funders that are interested either in some target sector(s) or in certain types of investments done. Developing relationships with these key funders early and building trust and support should be a priority.

Other methods of raising capital

Investors *for* impact have tried to find complementary revenue streams as a solution to financial sustainability issues. Adding peripheral activities (such as consultancy), finding ways to recycle capital (through debt instruments and by reinvesting capital gains) and generating economies of scale in the management fees (by raising larger funds) are examples of methods for obtaining more resources.

Resources

Report **"Learning from Failures in Venture Philanthropy and Social Investment"** (EVPA, 2014).

3) Recruiting a CEO and the management team

What is needed to be careful of when composing the team

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

The composition of the management team is obviously important, although it would be dangerous in a general discussion such as this one to be overly prescriptive. Professionalism is a necessary but not sufficient condition. Ideally, recruits should also 'share the vision' – i.e. be motivated by the social objectives of the investor *for* impact.

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

A small team, typically one to four people, may be an appropriate number to start with. The profile could focus on people who are patient enough to understand how the social sector works, but who may not necessarily be from the social sector. In general, there is a need for a mix of social and private sector backgrounds.

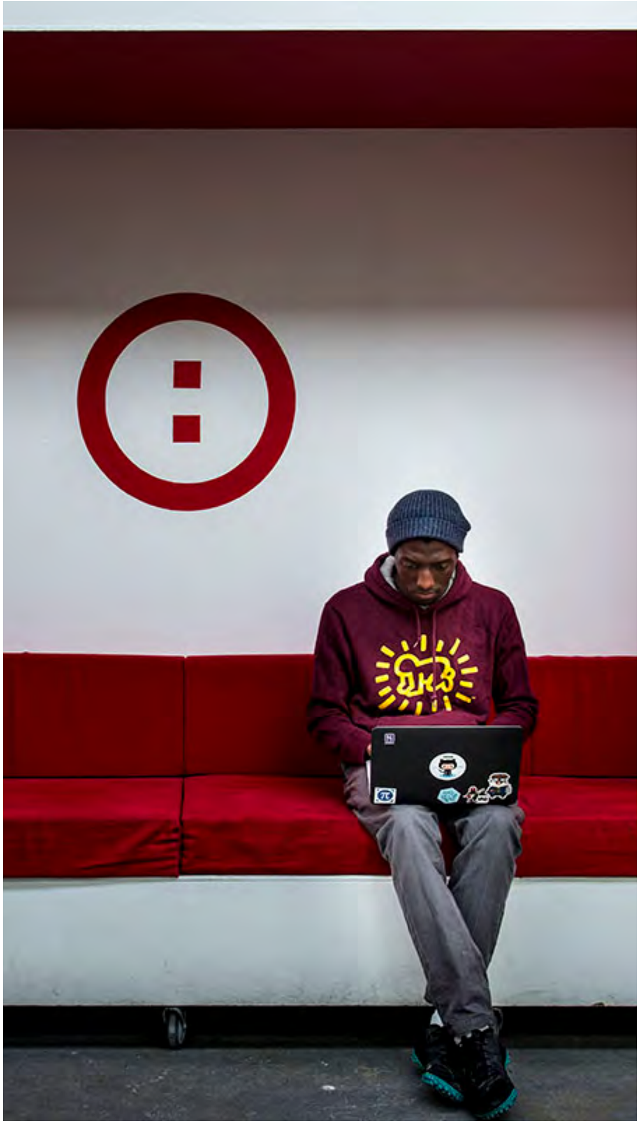
It may be difficult to attract ideal candidates at first. If it is necessary to compromise, calibre and energy are preferable to directly relevant experience. It may be necessary to upgrade a particular position when the hire has demonstrated success.

Most successful investors *for* impact in Europe have started with high-calibre teams that have significant experience – either held by the founders or gained through recruiting. According to EVPA's report *"Learning from Failures in Venture Philanthropy and Social Investment"*, the ideal team members often have basic financial skills. It is better to hire staff with a strong business or financial background (including business planning and financial skills) who can then learn how to apply their skills to the social sector.

Balancing between the social sector's perspective and the investor's perspective:

Different investors *for* impact have taken different approaches, when it comes to forming the team, to achieve the balance between the social sector's perspective and the investor's perspective, including:

- *Hiring both skill-sets into the management team*, i.e. hiring a very diverse team and working hard to ensure they learn from each other – building a learning culture.
- *Hiring a team with backgrounds that complement* those of the founder(s).
- *Hiring a team with investment back-grounds* and challenging them to develop a deep knowledge of the field at a rapid pace.



Simplon © Frederic Bieth

Resources

Report **"Learning from Failures in Venture Philanthropy and Social Investment"** (EVPA, 2014) – see pages 39-41

4) Working out the role of the board

How to select the right board members and which roles they can play

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

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

During the start-up phase, when the organisation as a whole is in a learning mode with respect to investment decision-making, the board is likely to act as an investment committee for final investment approval. Later, boards may consider that adequate decision-making processes have been established, and may allow the investment committee to take over the investment decision process.

As the board is often involved in the decision process of investors *for* impact, there is a need for a governance structure that includes a balanced mix of experiences from both the private and social sector. Members of the board must be chosen on the basis of their entrepreneurial approach as well as their collaborative mind-set, patience and high ethical standards.

Finally, the board size should be kept small, typically three to five members. In cases where an organisation investing *for* impact needs a larger board (e.g. if several board seats are requested by the investors), it is recommended that the board's active engagement activities are assigned to a smaller sub-committee, which can meet frequently (e.g. monthly).

Drivers for establishing the board:

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

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

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5) Abiding by high ethical standards

How to guarantee the preservation of high ethical standards in the management of the activities

As investors *for* impact aim to achieve systemic change, they must abide by high ethical standards in managing their activities. EVPA has developed a Code of Conduct as a set of minimum principles, whose compliance is mandatory for EVPA members.

The Code of Conduct is founded on the principles of:

- Transparency, which entails openness about the operations of the organisation and enables the development of trust between actors in the impact ecosystem, enhancing the reputation of the industry.
- Ethical behaviour, which comprises integrity, fairness and responsibility.
    - Integrity implies not gaining competitive advantage and commercial success through manipulative practices.
    - Fairness relates to abiding by the existing rules.
    - Responsibility implies being accountable for own mistakes and using them as a learning tool.
- Mutual respect, which is avoiding stereotyped prejudices.
- Professional business conduct, which entails ensuring efficiency and sustainability and responsibly conducting the operations.

The primary objectives of the EVPA Code of Conduct are:

- *Set the standards* of conduct for an industry in continuous development.
- *State the principles of ethical behaviour* for EVPA members.
- Assert on behalf of the membership the collective view that the *highest professional standards* as well as *just and equitable principles of philanthropy, trade and investment* shall be observed.
- *Address lapses* in professional conduct when they occur within EVPA.
- *Act within the rule of law and business rules* of the jurisdiction of the EVPA member.

Another key element of upholding high ethical standards relates to the eagerness in collecting and sharing both impact and financial data. In this regard, EVPA is committed to collecting and analysing data from practitioners from all over Europe, running the EVPA Industry Survey since 2010. The Industry Survey provides independent statistics on the impact space, with the aim of understanding the strategies and practices of investors *for* impact. EVPA firmly believes that the Industry Survey is an essential tool for the impact ecosystem to grow and unleash its impact potential, and encourages all investors *for* impact to share their data.

As identified in the "Roadmap for investors *for* impact", included in the report *"15 Years of Impact – Taking Stock and Looking Ahead"*, structuring data and extracting valuable information to maximise social impact is a key objective for investors *for* impact. EVPA states that in the next decade, investors *for* impact should be able to (i) use data and evidence to anticipate long-term issues that will affect people and the planet and take action; and (ii) aggregate data and compare them with baselines to show contributions and progresses at impact sector level.

Apply the Charter of investors *for* impact – Principle 10

10.

...UPHOLD HIGH ETHICAL STANDARDS

- Behave ethically, ensuring integrity, fairness and responsibility.
- Embrace transparency.
- Believe in the power of evidence.

Resources

Code of Conduct **of EVPA** (2020)

Industry Survey **of EVPA** (2010 – 2020)

Report **"15 Years of Impact – Taking Stock and Looking Ahead"** (EVPA, 2019) – see "Roadmap for Investors *for* Impact" at pages 88-89


Fire exit
Keep clear
Ariful
Angel
Zaine

II.

INVESTMENT STRATEGY


FIRE EXIT
Fire exit
Keep clear
ASTRONOMY
Radius = 2,440 Km
Ariful
Angel
Zaine
Fatima
Gabriella
Staff use only

II. INVESTMENT STRATEGY

The investment strategy of the investor *for* impact is composed of eight main elements:

- The *impact measurement and management strategy* and the development of the Theory of Change.
- The *social focus* of the operations.
- The *geographical focus* of the operations.
- The *type of social purpose organisations* supported.
- The *type of financial instruments* deployed – the investor *for* impact can use a range of financial instruments, such as grants, loans/debt, equity and hybrid financial instruments.
- The *non-financial support* – the investor *for* impact needs to decide how much non-financial support to provide, what type of NFS is core or non-core to its investment strategy and who provides each type of support. The non-financial support offered needs to be in line with the goals of the investor *for* impact in terms of financial return and social impact, as defined in its Theory of Change.
- The *collaboration with other actors*, including the co-investment policy.
- The *exit strategy* – it is recommended that investors *for* impact already think about how they will exit their investments as part of developing their investment strategy, allowing them to assess variables such as duration of the investment and potential exit routes.

CHECKLIST

- Defining how to measure and manage social impact
- Defining the social problems to tackle and applying appropriate strategies
- Defining the geographical focus
- Defining which type(s) of social purpose organisations to support
- Selecting which financial instrument(s) to use to support which SPO(s)
- Defining what non-financial support to offer
- Defining how to collaborate with other actors
- Thinking about the exit already as part of the investment strategy

1) Defining how to measure and manage social impact

Understanding the change to seek and how to define it

EVPA's report *"A Practical Guide to Measuring and Managing impact"* helps investors *for* impact look at impact measurement and management (IMM) as a learning process. The EVPA five-step approach guides investors to define their social impact objectives and embed them in the overall impact measurement system, allowing them to better manage the impact generated through their investments.

Investors *for* impact should go through all the steps of the framework with their investees throughout the investment process, and then the IMM process will finally occur in the course of the investment management phase.

Investors *for* impact should keep in mind that they will not only have to measure (and eventually aggregate) the impact of their investees, but also assess the impact of their own activities. This second level of measurement consists in measuring the value of the financial and non-financial support provided. Thus, while defining the investment strategy, investors *for* impact already start focusing on step 1 of IMM i.e. setting objectives, at the investor level.

There are five factors investors *for* impact have to consider when defining the scope of impact management: (i) what is their motivation for measuring social impact; (ii) what resources they can dedicate to impact measurement – including financial, human, technological and time resources; (iii) what type of SPOs they are working with; (iv) what level of rigour they require in their impact analysis; and (v) what is their time frame for measuring impact.

The more accurate and customised IMM is, the lower the risk of not achieving the intended social impact, or generating unintended negative consequences. However, investors *for* impact should be careful not to over-claim and to take into consideration the attribution.

Defining the Theory of Change (ToC)

Investors *for* impact start by defining their own social objectives, continuing with the development of a Theory of Change to articulate how and why they expect to achieve change through their activities to solve a particular social problem. Moreover, a clearly articulated Theory of Change is also necessary to be able to choose investments in SPOs that can contribute to solving the social issue that the investor *for* impact is addressing.

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

The Theory of Change and the financial return expectations are the cornerstones of the investment strategy, and will help investors *for* impact further refine their investment strategy.

Defining a ToC in practice:

- The investor *for* impact needs to determine the *overarching social problem* or issue that it aims to alleviate – e.g. youth unemployment in Spain (including an assessment of the magnitude of the problem as the base case).

- The investor *for* impact needs to determine the *specific objective* it wants to achieve – e.g. to reduce youth unemployment in Spain by investing (financial and non-financial support) in social enterprises with innovative solutions to introduce youth in the labour force (including an assessment of what the greatest needs of such social enterprises are and how the investor *for* impact can help them).

- The investor *for* impact needs to determine the *expected outcomes* – what the investor *for* impact must achieve to be considered successful (the milestones against which the investor *for* impact will be measured) – e.g. the reduction of youth unemployment in Spain by 2 percentage points in 5 years.

Impact Measurement and Management

The objectives selected during step 1 should be “SMART”: specific, measurable, attainable, realistic and time-bound.

In practice, “SMART” means:

- *Specific*: the objective is specific if it is clearly written so relevant parties easily understand it. The party should be able to define what is to be done, the rationale or benefit related to meeting the outcome or goal and what requirements are necessary.

- *Measurable*: the objective is measurable if it covers at least one measure of a quality metric, quantity, time and/or cost-effectiveness. Measurable means not just meeting a standard but evaluating to what extent the standard needs to be met. Without a specific measure the party is not able to self-monitor how they are doing relative to the overall objectives of the organisation.

- *Attainable*: the objective is attainable by the organisation if it is appropriate, given the resources (time, human, capital, technology) it has at its disposal. It should allow for some stretch to encourage the organisation to meet its goals.

- *Realistic*: the objective is realistic if it is within the organisation’s reach to achieve, given the external context in which its activities take place.

- *Time bound*: the objective is time bound if it can be accomplished within the evaluation period that has been set by the organisation.

Figure 7: Step 1 of IMM

Apply the Charter of investors *for* impact – Principle 5

5.

… MEASURE AND MANAGE SOCIAL IMPACT

- Commit to a set of common principles of impact measurement and management, to maximise social impact while minimising the risk of impact washing.
- Collect data, not only to measure the impact, but in order to systematically refine the impact strategies and to take better informed decisions.
- Help social purpose organisations set up their own impact measurement and management system to maximise their social impact.

Resources

Report **"Measuring and Managing Impact – A Practical Guide"** (EVPA, 2015).
Leaflet **"Impact Management Principles"**, co-developed by EVPA and Social Value International (EVPA/SVI, 2017).
Report **"Impact Measurement in Practice: In-depth Case Studies"** (EVPA, 2016).

2) Defining the social problems to tackle and applying appropriate strategies

Guidance on how to choose a sectorial focus

NEST © Joan Bardeletti

As part of the definition of the investment strategy, investors *for* impact should define if they will have a sectorial focus (and which one) or if they will be sector agnostic. On the one hand, an advantage of having a sectorial focus is that it allows investors *for* impact to bring more added value in the areas where they have developed a learning curve. Measuring impact is also facilitated by a clear investment focus on one particular social sector: there will be fewer, if any, problems with aggregating data at portfolio level.

On the other hand, having a broad-based portfolio allows start-up investors to appeal to a wide variety of stakeholders. Moreover, investors *for* impact operating in a small market may be forced to focus on multiple sectors, as the deal flow related to one specific sector would be too limited.

As the impact ecosystem becomes more established, more and more investors *for* impact are becoming sector agnostic, looking for opportunities to invest in innovative ventures, regardless of the sector in which these SPOs are active. As a consequence, the large majority of investors *for* impact support multiple sectors and beneficiaries.

Apply the Charter of investors *for* impact – Principle 4

4.

... TAKE RISKS THAT MOST OTHERS ARE NOT PREPARED TO TAKE

- Be prepared to take both financial and impact risks betting on new solutions.
- Be willing to accept a less attractive risk/return ratio than other investors, if you believe in the potential impact of the proposed solution.
- Create the pipeline for follow-on investors by providing early-stage high-risk capital.

3) Defining the geographical focus

How to choose a geographical focus ensuring to be efficient and impactful

Investors *for* impact need to define the geographical scope of their activity as part of their investment strategy. Most European investors *for* impact invest in their own domestic market or in developing countries.

Investors *for* impact that adopt an international focus face additional costs and management complexities in comparison with those operating within a single national jurisdiction.

Engaged portfolio management is more complicated if the investee organisations are dispersed across several countries, while the development of an overseas network is necessary to maintain deal flow. Travel, legal advice and taxation advice will impose additional costs. Often, investors *for* impact investing internationally rely on local offices and partners.

Questions about the impact investment market in the target geography need to be explored in this context as well. Is there a sizeable social need that the organisation investing *for* impact can address in a meaningful way? Is there sufficient deal flow to ensure that an appropriate level of investments will result?

A market study is normally required to understand the relevant demographics and the quantity, quality and size of potential investment targets. To ensure that the investor *for* impact can selectively invest in high-quality organisations, the number of potential investments should significantly exceed the total number of investments required to fill the portfolio.

Eau et Vie © Trafigura Foundation

4) Defining what type(s) of social purpose organisations to support

The types of social purpose organisations that investors tend to work with and ways to select the right social purpose organisations to support

By adopting the venture philanthropy approach, investors *for* impact can support different types of SPOs, from charities and non-profit organisations to social enterprises and socially driven businesses.

As shown in the EVPA spectrum (Figure 2 at page 8), on the left side of the spectrum, there are social purpose organisations that will never be financially / self-sustainable. These organisations provide valuable social products or services with no market outlet and can therefore be supported by traditional grant-makers and/or by engaged grant-makers. Investors *for* impact also support SPOs with a potentially financially / self-sustainable business model, by providing either grants (e.g. first-loss grants) or repayable financial instruments. SPOs with a proven financially sustainable business model can be supported by investors *for* impact, but they can also attract investors *with* impact since they have already generated track records. Additionally, investors *with* impact also support traditional businesses with intentional social impact, which can generate financial returns on their investments, alongside social impact.

Another important aspect of the SPO is its stage of development. SPOs go through four sequential stages – which constitute their life cycle: (i) pre-seed/seed, (ii) start-up/early stage, (iii) validation, and (iv) preparation to scale and scaling. Investors *for* impact mostly invest in organisations during their start-up and validation stages, which have the potential to develop new and innovative solutions to pressing social challenges. The early stage of development calls for more patient capital and this could reduce the funding possibilities. Investors *for* impact, hence, take the risk inferred from supporting SPOs in their first stages of development and construct a pipeline for other investors, which may come in during the scaling phase. In the case of SPOs that will never be financially / self-sustainable, an important actor in their scaling phase is the public sector, which might recognise the value of the solutions developed by the SPO and consider taking them over and scaling them.

IntoUniversity © Liam Arthur

Finally, investors *for* impact support SPOs that actively involve final beneficiaries in their activities, and put them at the centre of the solutions. Sometimes, the founder of the SPO may be a beneficiary itself. Depending on the SPO's business model, the final beneficiaries can have two roles: being employees of the SPO or being customers (Hehenberger, 2019). If the beneficiaries are employees of the SPO, they should be treated as such, so that they feel empowered and treated with dignity. When beneficiaries are customers, their needs should be well understood and they should be involved in the creation of the solution. Lastly, if investors *for* impact want to put beneficiaries at the centre of the solutions, they "should entrust them with more agency, and perhaps calling them agents of social change" (ibid).

Types of final beneficiaries targeted by the SPOs supported by investors *for* impact are: children and youth (including teens, NEETs, etc.); elderly people; women; people with disabilities; people with diseases (either mental or physical); re-offenders; migrants, asylum seekers and/or refugees; unemployed people; minority ethnic communities; and people in poverty, among others. As these categories are not mutually exclusive, some SPOs target more than one category at a time.

Apply the Charter of investors *for* impact – Principle 2

2.

... PUT THE FINAL BENEFICIARIES AT THE CENTRE OF THE SOLUTIONS

- Support solutions co-created with final beneficiaries.
- Encourage social purpose organisations to proactively involve beneficiaries in their activities.
- Be primarily accountable to final beneficiaries.

Resources

Report **"Impact Strategies – How Investors Drive Social Impact"** (EVPA, 2018).

Article**: "The agents of change in social entrepreneurship"** (Hehenberger, L., 2019).

5) Selecting which financial instrument(s) to use to support which SPO(s)

Definitions of the main financial instruments

Financial instruments are contracts involving monetary transfers through which investors *for* impact financially support social purpose organisations (SPOs). The financial instruments used in the impact ecosystem are broadly similar to those used in the commercial investment sphere, but also include the grant and grant-related financial instruments.

The three main types of financial instruments:

- *Grants* are a type of funding in the form of a cash allocation that investors *for* impact can offer to SPOs. From SPOs' perspective, grants do not foresee any type of repayment or any financial returns to be given back to the investor. From the investors' perspective, grants do not establish any ownership rights.

- *Debt instruments* are loans investors *for* impact can provide SPOs with charging interest at a certain rate. The interest charged can vary depending on the risk profile of the investee (i.e. the SPO); on its potential social impact; and on the securitisation and repayment priority of the loan (e.g. senior vs subordinated loan).

- *Equity instruments* are contracts through which investors *for* impact provide funding to SPOs and in return acquire ownership rights on part of the SPOs' businesses. This form of capital can be appropriate when the prospect of a loan repayment is low or non-existent. If the SPO is successful, the equity share holds the possibility of a financial return in the form of dividend payments and/or the capital gain at the exit. In addition, it allows for the possibility of a transfer of ownership to other funders in the future.

Moreover, investors *for* impact can also support SPOs by using hybrid financial instruments (HFIs). HFIs are monetary contracts that represent a variation or combine features of the traditional financial instruments (grants, debt instruments and equity instruments) in order to achieve the best possible alignment of risk and impact/financial return for particular investments. As experts from the field described, HFIs are financial instruments that attempt to reconcile some of the basic tensions between the financial requirements of the investors and the impact motivation of the social entrepreneurs (Varga and Hayday, 2019).

CottonConnect ©Ben Langdon for C&A Foundation

Some examples of hybrid financial instruments are mezzanine finance, convertible loans (or convertible debt), recoverable grants (or convertible grants), soft loans, revenue sharing agreements (or royalty-based financing), and forgivable loans.

Hybrid financial instruments – some examples:

- *Mezzanine finance* is a hybrid of debt and equity financing, usually used to fund the scaling of an organisation. Although it is similar to debt capital, it is normally treated like equity on the organisation's balance sheet. Mezzanine finance involves the provision of a high-risk loan, repayment of which depends on the financial success of the SPO. This hybrid financial instrument bridges the gap between debt and equity/grant through some form of revenue participation.

- *Convertible loans* (or convertible debt) are loans that may be converted into equity. Convertible loans are most often used to support SPOs with a low credit rating and high growth potential. Convertible loans are also a frequent vehicle for seed investing in start-up SPOs, as a form of debt that converts into equity in a future investing round. It is a hybrid financial instrument that carries the (limited) protection of debt at the start, but shares in the upside as equity if the start-up is successful, while avoiding the necessity of valuing the company at a too early stage.

- *Recoverable grants* (or convertible grants) are grants that investors *for* impact use to fulfil a role similar to equity. Recoverable grants may include an agreement to treat the investment as a grant if the SPO is not successful, but to repay the investor *for* impact if the SPO meets pre-agreed KPIs with success. Recoverable grants are designed to focus the SPO on sustainability and to reduce its risk of grant dependence.

- *Soft loans* are debts investors *for* impact offer to SPOs with no interest (i.e. 0% interest rate loans) or with a below-market rate interest. The main difference with recoverable grants lies in the repayment scheme, which is agreed ex-ante between the two parts and it is not conditional to any specific KPI.

- *Revenue sharing agreements* (or royalty-based financing) are hybrid financial instruments in which the investor *for* impact lends money to the SPO against its future revenue streams. The initial capital plus an additional interest has to be repaid by the company until the pre-established amount is paid back (so called royalty cap), with repayments only starting when the company generates positive cash flow. Investors obtain returns as soon as the investees reach an agreed level of revenue. (Source: Jakimowicz, K., et al., 2017).

- *Forgivable loans* are the opposite of convertible grants. They are loans which are converted into grants in case of success. If the SPO reaches the goals agreed on beforehand by the investor and the investee, the loan does not have to be repaid. The SPO bears the full risk of project success and, on top of that, has a strong incentivation for making it happen as planned. (Source: Oldenburg and Struewer, 2016).

Resources

Leaflet **"Financing for Social Impact – Financial Instruments Overview"** (EVPA, 2020).

Report **"Financing for Social Impact – The Key Role of Tailored Financing and Hybrid Finance"** (EVPA, 2017).

Report **"A recipe book for social finance. Second edition: A practical guide on designing and implementing initiatives to develop social finance instruments and markets"** (Varga, E., and Hayday, M., 2019).

Report **"New financial instruments for innovation as a way to bridge the gaps of EU innovation support"** (Jakimowicz, K., et al., 2017).

Article **"Full spectrum finance: how philanthropy discovers impact beyond donation and investments"** (Oldenburg F., and Struewer, B., 2016).

Apply the Charter of investors *for* impact – Principle 7

7.

… TAILOR THE FINANCIAL SUPPORT TO THE NEEDS AND CHARACTERISTICS OF SOCIAL PURPOSE ORGANISATIONS

- Provide appropriate funding to support the different stages of development of social purpose organisations.
- Start from the societal solutions and reverse-engineer the financial support to provide.
- Ensure that there is a match between the financial support you can offer (i.e. grants, debt, equity or hybrid financial instruments – or a mix of them) and the needs of the social purpose organisation.

Don't forget…

While defining the investment strategy, step 1 of tailored financing should be applied to ensure that the assessment of the pre-conditions of the investor *for* impact is completed, as explained in part 1.1 at pages 22 and 23.

6) Defining what non-financial support to offer

Deciding what non-financial support (NFS) to provide to investees based on the investment strategy

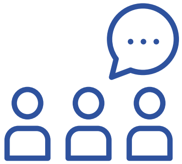
The non-financial offer of an investor *for* impact can be as important to the investee's development as the financial support provided.

As part of its investment strategy, the investor *for* impact should first consider the possible forms of non-financial support available to help the SPO advance on three core areas of development: social impact, financial sustainability and organisational resilience. EVPA distinguishes between specific support and generic support. Specific NFS is meant to impact a specific area of development of the SPO. The types of NFS that impact the development area of social impact are support in developing the Theory of Change and Impact Strategy, as well as support in managing the impact. Types of NFS related to financial sustainability are fundraising, revenue strategy and financial management. Finally, governance support and human capital support are aimed at strengthening the organisational resilience. Generic NFS is not meant to impact directly any specific area of development, but it contributes to all of the three in different ways. Examples of generic NFS are strategic support and operational support.

Based on its own impact objectives and Theory of Change, the investor *for* impact can choose which types of non-financial support are core to implementing its strategy. Once this mapping exercise is completed, the investor *for* impact should choose among these services the most relevant ones and distinguish between core support and non-core support.

It is recommended that the investor *for* impact asserts who can provide each type of support. Most of the organisations investing *for* impact offer non-financial support through their internal team, and some of them couple it with support from external contributors. Concretely, grant-making organisations tend to delegate their provision of non-financial support to external contributors more often than impact funds.

The investor *for* impact also needs to consider how it will finance the non-financial support it provides and – in order to do so – it needs to have a clear view of the real cost of the non-financial support provided, as well as the strategy to finance the different assets.



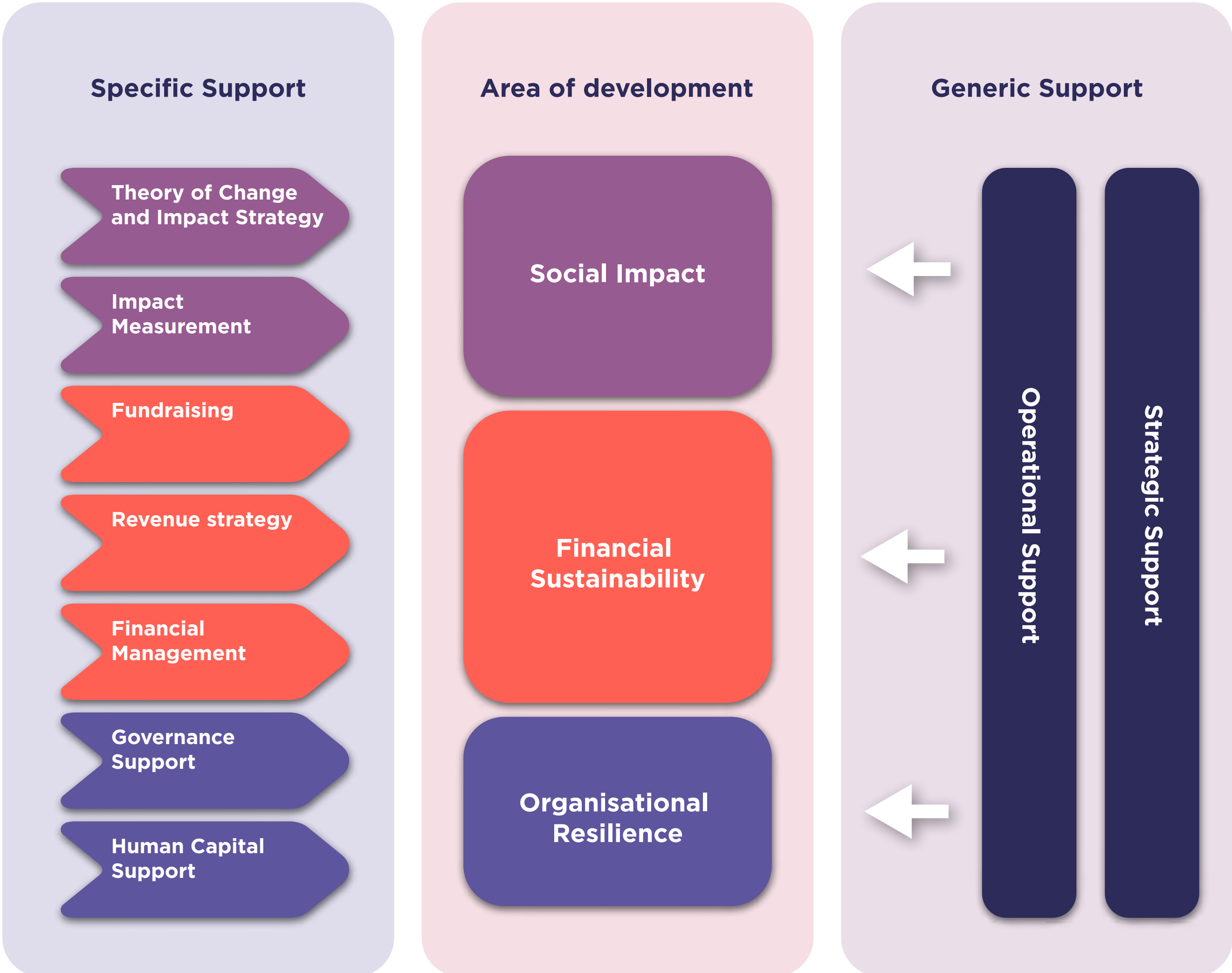


Figure 8: Mapping of non-financial support based on the three key areas of development of the SPO

Non-financial support

An important decision to be taken in this step is who provides non-financial support. NFS can be provided either by the internal team (i.e. paid employees and board members) or through external support.

External contributors can be pro-bono contributors (e.g. individuals with specific skills or knowledge on a topic, professional services firms, etc.), low-bono contributors (i.e. consultants that charge a reduced fee) or paid external contributors (such as consultants or academics).

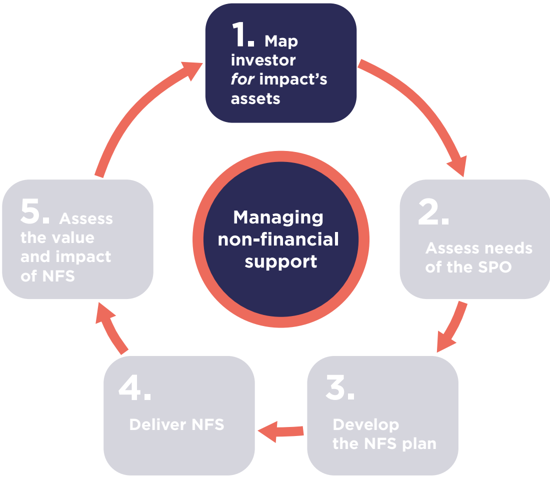


Figure 9: Step 1 of non-financial support

Apply the Charter of investors *for* impact – Principle 6

- Provide highly-engaged non-financial support to strengthen the three core areas of development of the social purpose organisation: social impact, organisational resilience and financial sustainability.
- Customise non-financial support to the social purpose organisation and its different phases of development.
- Provide sufficient time and strategic bandwidth to allow the social purpose organisation to succeed.

Resources

Report **"Adding Value through Non-Financial Support - A Practical Guide"** (EVPA, 2015).
Expert round-up**: "Commit time, not only money"** (EVPA, 2018).

7) Defining how to collaborate with other actors

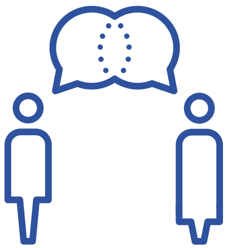
Collaborating with other actors and bringing in co-investors

Collaboration with other actors is particularly important within the impact space. Key players with whom to collaborate can be other investors *for* impact, investors *with* impact, traditional grant-makers, traditional investors, incubators and accelerators or the public sector.

A particular way of collaborating with other actors is co-investing. Co-investment can be an important part of an investor *for* impact's investment strategy. It represents an excellent way to raise funds to support SPOs through the venture philanthropy approach – and may be easier than raising funds for the investor itself. In addition, it can help promote VP among a wider audience. It also eliminates the 'blind pool' element, whereby investors are asked to fund unidentified organisations. It can help investors *for* impact target suitable trusts and foundations that are appropriate for a given investment. Co-investment does prompt certain cost considerations. Some investors may wish to charge co-investors a fee for managing the investment – to share overheads. This can often be a difficult negotiation. Co-investing can also be risky in particular if the co-investors do not have similar objectives. For example, purely financial co-investors might exit an investment that is doing well from a social impact perspective if it does not generate the desired financial return. This would force the investor *for* impact to look for other investors or to financially cover for the part of the co-investor that dropped out, in order to avoid the risk of failing and/or having the investee out of business.

Other aspects of the relationship that should be agreed upon are the co-investors' attendance to review meetings, their supply (or not) of value-added services, or the lead investor and the SPO's reporting obligations.

In addition to traditional co-investment, when multiple actors with different impact strategies join forces, they can engage with hybrid finance. Hybrid finance is the allocation of financial resources to impact-oriented investments combining different types of financial instruments and different types of risk/return/impact profiles of organisations investing *for* impact. Two common examples of hybrid finance are hybrid financing vehicles (developed at fund level) and hybrid financing mechanisms (developed on a deal-by-deal basis, e.g. social impact bonds, development impact bonds or social success notes). Part 3 of the EVPA's report *"Financing for Social Impact"* analyses these two elements and their main features.



Apply the Charter of investors *for* impact – Principle 8

8.

... PROACTIVELY ENHANCE COLLABORATION WITH OTHERS

- Go beyond supporting individual social purpose organisations, to achieve systemic and lasting positive change at scale, by also focusing on building an enabling ecosystem (at regional, national, and global scale).
- Acknowledge the importance of collaborating with peers when it creates value for the solution.
- Recognise the value of collaborating with others in the ecosystem – including the public sector, traditional philanthropic organisations, NGOs, investors *with* impact and corporations – aligning on a long-term vision.

Apply the Charter of investors *for* impact – Principle 9

9.

... WORK TO FOSTER THE MOBILISATION OF RESOURCES IN THE SOCIAL IMPACT ECOSYSTEM

- Share and communicate your successes and failures.
- Encourage other potential investors *for* impact to join the social impact ecosystem.
- Inspire the world towards *positive* and *significant* impact, encouraging all investors to integrate impact considerations in each practice and decision-making process.

Resources

Report **"Financing for Social Impact – The Key Role of Tailored Financing and Hybrid Finance"** (EVPA, 2017) – see Part 3

8) Thinking about the exit already as part of the investment strategy

Including exit considerations as part of the investment strategy, so that exits will never be at surprise

The exit is the end of the relationship between the investor *for* impact and the social purpose organisation. The nature of the exit will normally be agreed before the investment is completed. In the case of a charity, the investor *for* impact will ideally be replaced by a mix of other funders. In the case of a social enterprise, an exit may require the repayment of a loan, for example, and the timing will depend on the commercial success of the enterprise.

An exit strategy is an action plan to determine when the investor *for* impact can no longer add value to the investee, and to end the relationship in such a way that the social impact is either maintained or amplified, or that the potential loss of social impact is minimised. Having an exit strategy is necessary for investors *for* impact as they are committed to generating a long-lasting impact.

The exit needs to be carefully planned, managed and executed following the "exit strategy process". This process, defined by EVPA in the report *"A Practical Guide to Planning and Executing an Impactful Exit",* is composed of five steps: (i) determining key exit considerations, (ii) developing an exit plan, (iii), determining exit readiness, (iv) executing an exit and (v) post-investment follow-up.

As the exit constitutes the endpoint of the investment, the exit strategy needs to be aligned with the investment strategy. For this alignment to happen, the investor *for* impact must reflect upon its investment strategy, and determine the main elements that will influence its exit strategy, i.e. the key exit considerations (step 1 of the exit strategy process).

The exit strategy process

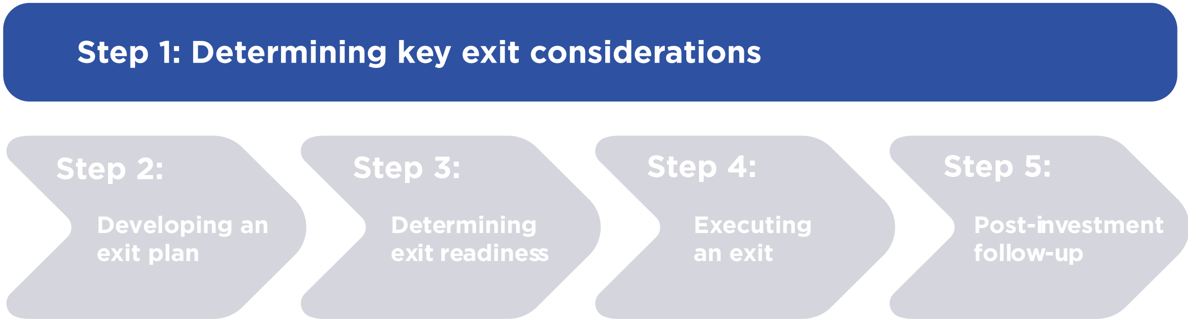


Figure 10: Step 1 of the exit strategy process

The key exit considerations:

- *Context:* the geographical and the sector focus of an investor *for* impact determine the context in which both the SPO and the investor operate and will therefore influence the exit strategy, especially in terms of whom to exit to and how to exit.

- *Type of investee*: the type and the stage of development of the investee influence how the investor *for* impact exits, to whom it can exit, and the milestones the investor *for* impact and the SPO use to define exit readiness.

- *Type of funding*: each financial instrument (debt, equity or grant) will have different benefits and different constraints on the exit strategy. The investor needs to perform an overall assessment of the instruments it uses to finance the SPOs in its portfolio, and how they influence the exit.

Eau et Vie © Trafigura Foundation

- *Co-investing*: co-investors with a broad network that can be leveraged are a very important asset, especially at the time of exit. However, co-investment also represents a challenge, as it requires alignment on different elements, such as investment strategy and objectives, financial/impact trade-offs and exit plans. A misalignment of the co-investors on the investment strategy can generate issues throughout the investment period and at the time of exit.

- *Relationship with the funders*: the way in which the investor *for* impact is funded has an impact on the investment strategy and on the key exit considerations.

Resources

Report **"Planning and Executing an Impactful Exit – A Practical Guide"** (EVPA, 2014)

III.

INVESTMENT PROCESS

WARC © Yonathan Adamchuk

III. INVESTMENT PROCESS

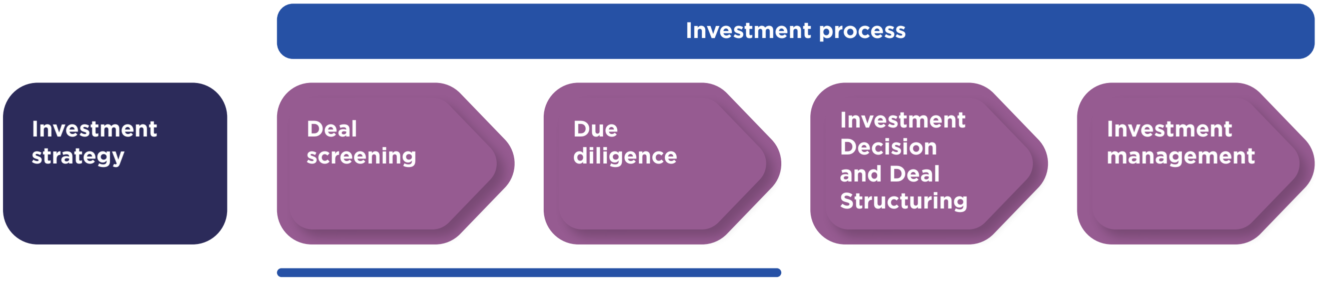


Figure 11: The investment process

For each investment, an investor *for* impact goes through an investment process as outlined in Figure 11. This process helps maximise the achievement of the social and financial return objectives at the time of exit. By properly managing the process, the investor maximises its exit options and works to enable the most appropriate and impactful use of its resources. The investor *for* impact should plan, monitor and execute the investment with the final aim of leaving behind an SPO that has a stronger business model and organisational structure and that is capable of attracting and managing the resources necessary to pursue its social impact goal(s) in the long term.

After assessing the key elements of its investment strategy, the investor *for* impact screens the investment opportunities available (deal screening). After the first phase, a detailed screening (or due diligence) helps the investor *for* impact decide which SPOs to invest in and define how to structure the deal (investment decision and deal structuring). The investment management at both SPO and portfolio level follows the investment appraisal phase.

CHECKLIST

- Deal screening
- Due diligence
- Investment decision and deal structuring
- Investment management

1) Deal screening

Guidance on how to identify potential investment targets in line with the investment strategy

Generating high-quality deal flow is one of the most important challenges of investors *for* impact and it should receive the same level of priority as fundraising. Even if this is not immediately apparent, the task is likely to be just as difficult. Finding investment opportunities that offer a good fit with the investor's objectives can be crucial to securing investment. The type of investee that is the target of the VP approach is sometimes hard to find. In many ways, investors *for* impact have to take an active part in creating the market and good ideas may need to be incubated.

Due to the possible lack of suitable social purpose organisations available, identifying and approaching target SPOs directly is the recommended route to securing initial deals. Managing open funding applications is another option, but it can impose significant administrative burdens without providing any guarantee of success. Managing an open application process can create a pool of disappointed applicants that can have a negative impact on the investor's reputation. Moreover, the investor *for* impact has to decide whether to operate a 'gated' process, in which it invites applications at specific times, or it has an always-open application process. The former can be very cost-effective in terms of generating and processing deal flow but it presupposes (i) good marketing channels for the organisation to broadcast its process; (ii) a fairly mature SPO market where organisations will be open to responding to a gated process; (iii) a well-branded organisation, with an existing track record; and (iv) a good network that can support spreading the voice.

Different ways of identifying potential investment targets:

- *Networking* with intermediaries, other funders, and, in particular, potential co-investors with a deep knowledge of the field of interest (preferred investee identification activity by European investors *for* impact).
- Speaking at *sector-specific conferences*.
- Through *existing portfolio organisations*.
- Through *desk research*.
- *Connecting with VC funds* that have dropped high-risk deals, which could be of interest.
- Looking for *SPOs implementing projects within the focus area* of the investor.
- Organising *business plan competitions*.

Eau et Vie © Trafigura Foundation

Other measures can help optimise deal flow:

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

- Working with a *small group of aligned co-investors* will significantly improve the quality of the deal flow. These may be foundations or trusts, other individual philanthropists, a corporation or even a state funder. If the co-investors are older than the organisation investing *for* impact, they will have an existing pipeline, relationships and market knowledge, all of which can save the investor time.

- *Selecting marketing channels* (considering that, in any case, word of mouth is the most powerful channel of all):

- Website, web links, annual reports, publications, conference presentations, etc.

- Current investees.

- *Casting the net widely* (e.g. by publishing information and application forms on the web) may trigger many applications, but they may not be of the right quality. It is also important to communicate the type of projects that might not be in scope.

- Developing a *clear positioning around value-added services* – and articulating it very clearly to SPOs. There is the need to differentiate from all other funding sources, including other philanthropists, state and corporate funders.

- Providing a *case example* of an ideal investment.

AfB Social and Green IT

First screening

The outcome of the first screening is the basis for the investor *for* impact's initial decision. Detailed screening will only be completed for organisations with a serious chance of securing investment. As such, the first screening should not consume much time from the investor.

First screening – a two-step approach:

- *Step 1*: desk screening of strategic fit between investor and investee. Aspects to analyse are thematic focus, geography, investment size and social relevance/impact.

- *Step 2*: discussions with management to get acquainted and to get an overall view of the organisation and its activities, projects, partners, etc. – including a preliminary needs' assessment and whether the investor *for* impact can add value.

Setting impact objectives

The impact objectives of the investor *for* impact set during the investment strategy will guide the deal screening, narrowing down the type of SPO(s) that will be considered for investment. For each potential investment, it is important to evaluate the expected outcome of the SPO and how the investor *for* impact expects to contribute to that outcome.

At the SPO level, the elements that should be defined are (i) the social problem the SPO is trying to solve, (ii) the activities the SPO is undertaking to solve the social problem or issue, (iii) the resources or inputs needed to undertake these activities, and (iv) the expected outcomes.

Don't forget...

Setting objectives is part of step 1 of impact measurement and management, which starts being developed at the investor level during the investment strategy, as described at pages 39-42.

Conducting a first assessment of the SPO’s needs

At this stage, the investor *for* impact makes a preliminary assessment of both the financial and the non-financial needs of the SPO (i.e. step 2 of tailored financing and step 2 of non-financial support).

Tailored financing

During the first screening, investors *for* impact should start considering step 2 of tailored financing, which is assessing the financial needs of the SPO. Specifically, they should consider internal factors and external factors. The internal factors are the SPO’s business model, organisational structure and stage in the life cycle, whereas the external factors are the macro-environment, which is a combination of geography and sector, and the stakeholders. These factors are further analysed during the due diligence phase (see page 74).

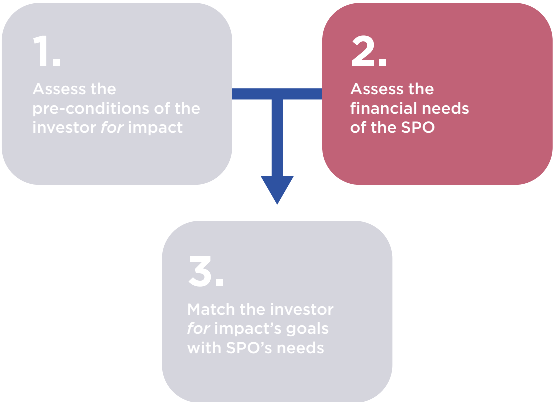


Figure 12: Step 2 of tailored financing

Taking into account the key exit considerations

The development of the exit strategy of the investor *for* impact is an integral part of its investment strategy and the alignment of both is a crucial pre-condition for a successful exit. The key exit considerations developed in parallel to the investment strategy will guide the investor *for* impact throughout the investment process and especially in the deal screening, i.e. in assessing which investment opportunities fit with its social impact and financial return goals.

Non-financial support

Once the investor *for* impact has clearly defined its objectives, what it can offer and has mapped its resources, it proceeds to map the needs of a specific SPO to invest in, across the three core areas of development (i.e. social impact, financial sustainability and organisational resilience). During the first screening, the investor *for* impact carries out a "light" assessment to check whether the needs of the SPO broadly match with what it can offer. An in-depth analysis will be carried out during the due diligence, and is further explained at pages 75-77.

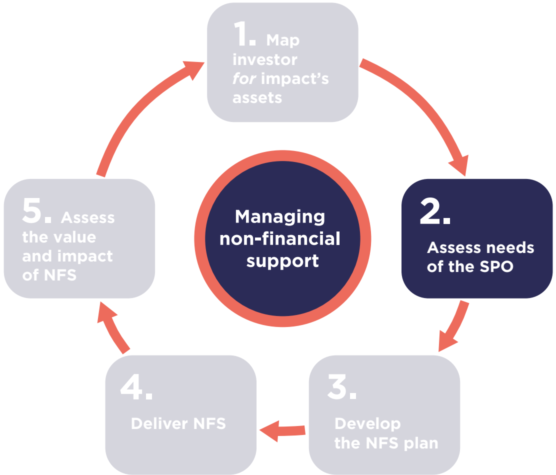


Figure 13: Step 2 of non-financial support

Don't forget...

When screening SPOs, investors *for* impact should take into account the key exit considerations, already assessed during the investment strategy (step 1 of the exit strategy process, at pages 60-61).

2) Due diligence

How to perform due diligence to choose the deal that is most in line with the investment strategy

Living Well with Dementia - Genio

The due diligence, which is a detailed screening, is usually performed (at least in part) through the analysis and validation of a business plan. Interviews with SPO's management, staff and board, review of relevant documentation and research on external information sources are of crucial importance.

Discussing the IMM strategy (I)

During the due diligence, investors *for* impact should dig deeper into the questions asked in step 1 of the IMM process, analysed during the investment strategy (see figure 7 and pages 39-42), and during the deal screening (see page 69). At this stage, it is a good practice to take a bottom-up approach to the IMM process. Starting from the business model of the potential investee, investors *for* impact can start reflecting on objectives that each investee can use to measure and monitor the social impact created. This should be coupled with a preliminary stakeholder analysis (step 2 of IMM), which is an integral part of the due diligence phase. To avoid wasting resources, it is advisable for investors *for* impact to increase the intensity of the analysis as it becomes more likely that the investment will be realised. At the same time, investors *for* impact should start verifying the impact the SPO claims to have (step 4 of IMM).

Impact Measurement and Management

After setting objectives (step 1 of the IMM process), investors *for* impact perform stakeholder analysis (step 2). A stakeholder can be defined as any party effecting and/or affected by the activities of the organisation. Investors *for* impact start by identifying the stakeholders i.e. mapping, selecting, and understanding their expectations. Then, they engage with the selected stakeholders.

Concurrently, investors *for* impact should start verifying whether the claim made by the SPO on having positive social impact is likely to be true and, if so, to what extent (step 4 of the IMM process).

Figure 14: Steps 1, 2 and 4 of IMM

Assessing the financial needs of the SPO

A first preliminary assessment of the financial needs of the SPO should have been carried during the first screening, as shown in Figure 12 at page 70. However, during the due diligence, the investor *for* impact works together with the SPO to determine its needs. The first question to be answered at this stage is: "Does a market (commercial or public) exist for the SPO's products/ services or activities?" Four scenarios are possible, looking at the business model and organisational structure of the SPO:

- The SPO has a business model that allows it to become self-sustainable, with an organisational structure very close to a traditional commercial organisation.
- The SPO has a business model that will never become self-sustainable, with a charity/NGO status.
- The SPO has the potential to build the market and then become self-sustainable.
- The SPO has some profitable activities and/or products/services combined with a part of them that will never become self-sustainable. In this case, the SPO has a hybrid structure.

Alongside the business model and the organisational structure, the third internal factor to consider is the SPO's stage in the life cycle, which can be (i) pre-seed/ seed, (ii) start-up/early-stage, (iii) validation, and (iv) preparation to scale and scaling. As for the business model and the organisational structure, also for each stage of development, there is a different funding need.

In this phase, it is also relevant to consider the external factors that will have an effect on the SPO's funding needs. The main external factors are the macro-environment – i.e. the geography(-ies) where the SPO is operating and the sector(s) it is active in – plus the SPO's stakeholders.

Don't forget...

The in-depth assessment of the financial needs of the SPO, based on the business model and the stage of development, is part of step 2 of tailored financing, explained at page 70.

Assessing the needs of the SPO for providing non-financial support

As for the financial offer, a first assessment of the needs of the SPO concerning the non-financial support needed should have been made during the first screening, as shown in Figure 13 at page 71, and it is further assessed during the due diligence phase..

A complete assessment of the needs of the SPO is crucial, as it lays the bases for the matching of the offer and the needs that will happen in the NFS plan. The needs of the SPOs can be mapped using a "needs' assessment tool". The points to be assessed across the three areas of development are summarised in the box of pages 76-77.

The due diligence process will require cooperation between investor and SPO, enabling each of them to see where and how they can add value (it is a learning process). Transparency is crucial at this stage, since many SPOs may not be familiar with practices that the investor may regard as a standard way of working. Being involved in the due diligence process also creates commitment and motivation for a positive outcome. The extent of engagement during the appraisal process should be weighed against the level and form of engagement the investor *for* impact will adopt during the investment phase.

Don't forget...

The in-depth assessment of the needs of the SPO is part of step 2 of non-financial support, as shown at page 71.

Resources

Report **"Adding Value through Non-Financial Support - A Practical Guide"** (EVPA, 2015) – see SPO's needs' assessment tool at pages 70-71

Assessing the needs of the SPO, according to the three areas of development, to come up with a potential NFS plan

Social Impact

- *Theory of Change*: it is vital to gain a detailed understanding of the current and expected social impact of the SPO. Not only does it reduce the risk of making the wrong investment, but it also creates a common understanding of the impact among all stakeholders and allows investor *for* impact and SPO to 'speak the same language'. If an SPO is claiming a certain outcome, then it needs to prove it. If the SPO cannot deliver the data, the investor *for* impact must consider whether it will bring in the expertise and provide the necessary support so the data can be collected, or question whether it is an appropriate investment at all.

- *Impact measurement systems*: track record of execution; impact measurement steps; social impact targets; monitoring and reporting on social performance. It is useful, as part of the due diligence phase, to check whether the impact monitoring system the SPO already works with is sufficient to meet the requirements of the investor *for* impact. Otherwise, the investor *for* impact may need to contribute to improving it through non-financial support, and these costs should be factored in before making an investment decision.

Financial Sustainability

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

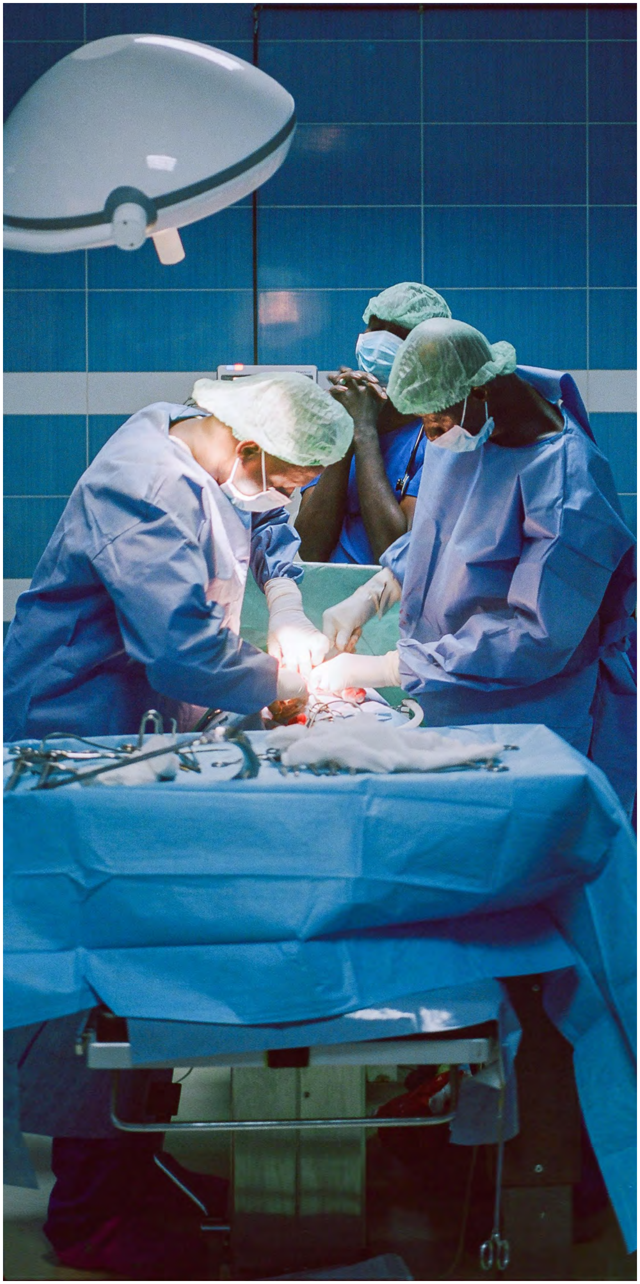
- *Sources of income*: funding trends and funding mix.

- *Financial:* history (results, previous financings); budgets and forecasts; funding gap/financial ask; co-financing; terms of investment, financial reporting and control process in place.

Organisational Resilience

- *Organisation*: legal structure; quality of management; governance; transparency of results, board quality. Dysfunctional SPO's boards are time-consuming and can constitute a major problem. Extensive reference checks on the management team are important not to overestimate the capabilities and the entrepreneurial spirit of the team of the SPO.

- *Operations*: what the SPO does to deliver on its strategy, including details of the organisation's income-generating model, if relevant. A technical review of the appropriateness and solidity of the product or service the SPO delivers/performs may be a part of the process.



NEST © Joan Bardeletti

Developing an exit plan (I)

Finally, another consideration the investor *for* impact and the SPO should start to consider at this stage is the exit plan, which is explained more in-depth in the deal structuring phase (see page 88).

The exit strategy process

Using the key exit considerations developed in step 1, the investor *for* impact and the SPO should start working together to co-develop the exit plan (step 2).

It is an essential step because it includes building the business case for the SPO, thus preparing the investee for the exit and making it attractive for potential follow-on funders. The exit plan starts in the due diligence phase, but it is further refined during the deal structuring.

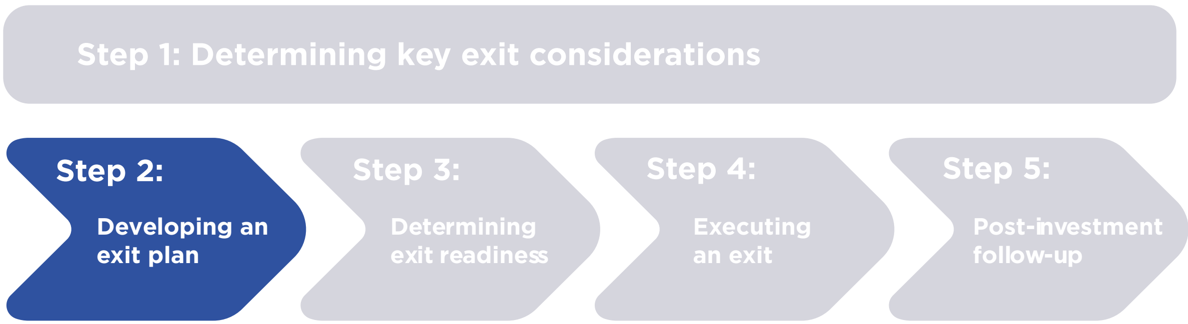


Figure 15: Step 2 of the exit strategy process

3) Investment decision and deal structuring

How to take an investment decision and how to structure a deal to avoid surprises at a later stage

At the time of structuring the deal, a crucial factor is the relationship developed between the organisation investing *for* impact's management team and the investment candidate. It enables the investor *for* impact to build trust and confidence in the SPO's ability to deliver during the investment phase. The interaction with the potential investee will help answer certain key questions, as displayed in the box below.

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

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

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

If the SPO is able to write its own plan, limited commitment will be needed from the investor, and the business plan will act as the starting point for first screening and discussions. However, other organisations will require assistance with business planning.

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

When deciding on investments, the recommendation is generally to avoid: investments in sectors or geographies in which the investor *for* impact has limited expertise or where the risk of not creating impact is too high; investments done too quickly or only to fill quotas, without adding strategic value; or finally, investments in SPOs not ready for the VP approach.

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

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

Managing negative decisions is another important part of the investment process. The investor *for* impact should build in several evaluation and decision-making steps within the overall appraisal process, so that it can, where necessary, refuse funding at an early phase of the investment process. The applicant should be made aware of each step in the decision-making process and the key criteria considered at each step. A challenge in deal selection is to say (an early) no to appealing but unpromising ventures.

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

When the deal is structured, investor *for* impact and SPO should work together to further discuss the impact measurement and management strategy, to choose the most appropriate financial instrument(s), to co-create a non-financial support plan and to continue developing the exit plan.

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Discussing the IMM strategy (II)

During the deal structuring, investor and investee discuss more in-depth the IMM strategy, focusing on the definition and selection of outputs, outcomes and indicators (step 3 of the IMM process) and on the monitoring and reporting of the results (step 5).

Regarding step 3, investors *for* impact strive for not only measuring outputs but also identifying and measuring outcomes. Outputs are the tangible products and services that result from the organisation's activities, while outcomes are the changes, benefits (or dis-benefits), learnings, or other effects (both long and short term) that result from the organisation's activities.

For what concerns step 5, it is essential that the investor *for* impact works with the SPO to develop an impact monitoring system that can be integrated into the management processes of the organisation, defining timings for each indicator, tools to be used and responsibilities. The cost of supporting and maintaining such a system (including personnel time and costs) should be part of the SPO's budget and hence the negotiation should include how this cost should and/or could be split.

Impact Measurement and Management

During the deal structuring phase, it is important to clarify who is responsible for measuring what, which will be useful then to carry out step 3 during the investment management. The responsibilities of who measures what should evolve over time as the SPO grows and develops, and should be reviewed on an annual basis. For impact measurement, the expected outputs, outcomes and impact, and the corresponding indicators should be defined before the investment is made and agreed upon by the investor *for* impact and the SPO.

Reporting requirements (to be used in step 5) should also be agreed upfront between the investor *for* impact and the SPO, preferably involving co-investors in the decision-making process to eliminate a multiple reporting burden for the SPO. Managing expectations about frequency and level of detail for reporting, and the way the SPO reports, will reduce the risk of problems later on in the process.

Figure 16: Steps 3 and 5 of IMM

Choosing the most appropriate financial instrument(s)

In the deal structuring phase, the investor *for* impact and the SPO need to choose which financial instrument will be used to support the SPO. This comes as step 3 of the tailored financing process.

Grants are particularly well suited to situations where the possibility of generating earned income is highly unlikely, undesirable or difficult to achieve within the investment horizon of the investor *for* impact. Grants are fundamental to creating a market or to financing a public good that no private investor would support at any point in time. Grants help building proof of concept at seed stage. However, grants have the potential to create a situation of dependency of the SPO, if not provided with adequate non-financial support to strengthen the financial sustainability and organisational resilience. Grants might give SPOs little incentives to maximise efficiency of funds, scale operations, and reach sustainability.

Debt instruments are considered when the investor *for* impact is looking for a fixed term and fixed return. For the investor, they are “safer” than equity, but they do not allow the investor to have any control over the decisions of the SPO. Additionally, SPOs in the very early stage of development might not have any collateral to offer, which implies that the exposure of the investor *for* impact might end up being the same as if it was investing through equity.

Equity instruments should be considered when there is, or is likely to be, a market available for the SPOs' products / services / activities. For the investor, equity guarantees a participation in the financial upside of the business but implies to also share risks and liabilities with the investee. The return on investment may take place over a very long time period and may require significant amounts of other sources of capital (e.g. grants) to achieve it.

In addition to grants, debt and equity, investors *for* impact can use *hybrid financial instruments* (HFIs) to support their investees. Even though hybrid financial instruments can be very useful to better customise the support to SPOs, they require financially-literate organisations to invest in, which can understand the way of functioning of such instruments. Moreover, not all investors *for* impact may know how to structure and deploy HFIs. In some cases, the term “hybrid financial instruments” and what it entails may not even be known, demonstrating that HFIs are still not easily understood and used, both by investors and their investees (Varga and Hayday, 2019).

Tailored financing

Once the investor *for* impact has assessed the financial needs of the SPO, and considering the financial instrument(s) it has available, it can decide whether or not to invest in the SPO. There can be two different scenarios: (i) the investor *for* impact has the possibility to pick among a range of financial instruments; or (ii) the investor *for* impact can only use a single type of financial instrument, e.g. due to its legal structure.

In the first case, the investor *for* impact should assess what is the best financial instrument to use, among the different possibilities available, which can be successful considering the assessments made in step 1 and step 2. In the second case, the investor *for* impact needs to assess whether the only financial instrument it can deploy is really the most appropriate to effectively finance the SPO and to match its own goals with the needs of the SPO, or whether it would be more convenient to find other SPOs to support and for the SPO to look for other types of financing.

Figure 18 looks at how to match the financial instruments the investor *for* impact has available with the SPO's financial needs according to its business model.

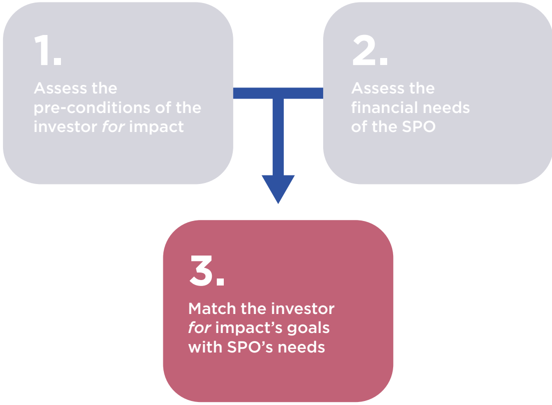

Figure 17: Step 3 of tailored financing

Resources

Leaflet **"Financing for Social Impact – Financial Instruments Overview"** (EVPA, 2020).
Report **"Financing for Social Impact - The Key Role of Tailored Financing and Hybrid Finance"** (EVPA, 2017)
Report **"A recipe book for social finance. Second edition: A practical guide on designing and implementing initiatives to develop social finance instruments and markets".** (Varga, E., and Hayday, M., 2019)

Matching the financial instruments the investor *for* impact has available with the financial needs of the SPO

Investor *for* impact	SPOs that will never be financially / self-sustainable	SPOs with a potentially financially / self-sustainable business model	Hybrid SPOs (with some of the products/ services generating revenues, but part of the activities not self- sustainable)	SPOs with a proven financially sustainable business model
Engaged grant-making	Grants	Grants *(seed/ market building)*	Grants *(for the non-profit part)*	Grants *(seed)*
Social investment		Repayable financial instruments *(validation and scaling)* Hybrid financial instruments	Repayable financial instruments *(for the income-generating part)*	Repayable financial instruments (scaling) Hybrid financial instruments

Figure 18: Financial Instruments Matching Table

Co-developing a non-financial support plan

In the deal structuring phase, and once the in-depth needs' assessment is complete, the investor *for* impact and the social purpose organisation (SPO) go together through a process of prioritisation and matching to guarantee that the non-financial support is correctly tailored to the needs of the investee. By matching the needs' assessment and prioritising areas of intervention, they develop the non-financial support plan (i.e. step 3 of the non-financial support process).

For each development area that has been agreed as a priority to be tackled, the NFS plan should include the baseline, goal, milestones, and target outcomes for the SPO, across the dimensions of social impact, financial sustainability and organisational resilience. The plan should also include the details of the support the investor *for* impact will provide to the SPO to achieve the planned milestones, and the concrete deliverables, e.g. having a governance system in place.

Non-financial support

Both SPO and investor *for* impact should formally engage in fulfilling their part of the non-financial support plan, and should flag potential issues or problems as they arise, allowing the plan to be flexible. As in all steps, transparency and communication are essential.

It is a good practice to present the NFS plan as a part of the documents signed in the deal structuring phase so that it represents a 'charter of engagement', which can be used by both parties as a pressure point towards the other to ask for delivery of results or support.

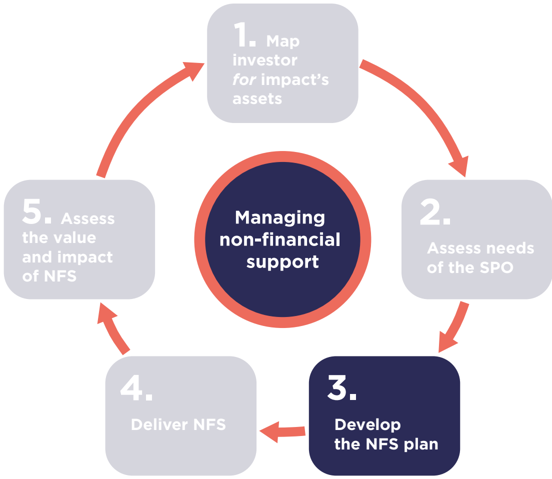

Figure 19: Step 3 of non-financial support

Resources

[Report] **"Adding Value through Non-Financial Support - A Practical Guide"** (EVPA, 2015) – see tool for implementing a non-financial support plan at pages 76-77

Developing an exit plan (II)

When structuring the deal, the investor *for* impact and the SPO should also discuss and co-develop an exit plan upfront (step 2 of the exit strategy process), which should have been already started during the due diligence, as outlined at page 78 and figure 15. The exit plan allows the two parties to clarify the key points related to the exit, which include the general goals of the investor (related to the financial, organisational and impact milestones of the investment), the expectations of both parties and the timing of the exit. The aim is to maximise the transparency of the relationship between the investor and the SPO and to clarify expectations.

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

Don't forget...

At this phase, the exit plan (step 2 of the exit strategy process), started during the due diligence and defined at page 78, is further developed.

Key elements of the exit plan:

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

Bednet © Raisa Vandamme

4) Investment management

How to manage a portfolio of investments, including the management at the SPO level

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Some investors *for* impact have a relatively small portfolio of organisations that are being actively supported at any given time. However, in choosing the size of their portfolios, investors *for* impact are also guided by the need of having a minimum number of investments to provide a sufficient spread in terms of investment risk and to demonstrate that their investment model works in a variety of situations. A maturing investor *for* impact will have an increased number of SPOs in its portfolio, all of which should be operating within the investor's focus area. Investors *for* impact that have been active for several years should acknowledge the greater need for portfolio management rather than just individual investee management.

As illustrated in the previous chapters, for what concerns the management at the SPO level, the plan for the investment phase engagement should have been discussed and agreed with the SPO during the investment appraisal process, to ensure there are no surprises.

Apply the Charter of investors *for* impact – Principle 7

3.

… BE HIGHLY ENGAGED FOR THE LONG TERM, STRIVING FOR LASTING IMPACT

- Take active ownership of the societal challenge and work very closely with the social purpose organisation to tackle it.
- Look for solutions that have the potential to be impactful in the long term.
- Strive to support social purpose organisations that can reach deeper social impact at scale.

Factors to consider when assessing the size of the portfolio:

- The *relationship between the investor and the investee:* is it limited to a single 'investment round' or will follow-on funding be needed? The term of the initial investment and the stage of development of the investee can influence this question.

- The *cost (internal or external) of any non-financial support* to be provided to the SPO.

- The *value of leveraging* – exchanging knowledge and experience among portfolio organisations, which can lead to the creation of significant added value with little or no additional cost.

- In general, a *large number of small portfolio companies* will consume more support costs (fund management costs) than a small number of large portfolio companies, without necessarily generating any additional impact.

Aspects to consider when managing the portfolio:

- Investor *for* impact's *impact measurement and management system:* a common ambition for investors *for* impact is to aggregate impact data coming from different SPOs. Thus, they face the trade-off between co-creating impact objectives and indicators with each SPO and finding common indicators to aggregate impact results at portfolio level.

- *Flagship investments*: selecting investments in well-recognised and reputable SPOs can be a valuable way of building credibility in the sector and providing leverage for future investment activity. However, this will prevent from investing in newly set up SPOs that might have a great potential in terms of impact.

- *Complementarity*: it will enhance the mission of the investor *for* impact, as well as the prospects of individual portfolio SPOs, when investments are made in organisations that complement each other rather than compete against each other.

- *Competition for resources*: inevitably, portfolio SPOs will compete for the investor *for* impact's resources – both financial and non-financial support. Good account managers can help minimise any problems that arise.

- *Facilitation*: portfolio managers should be encouraged to create links between portfolio SPOs that have the same client base, or that share the same suppliers.

- *Feedback from SPO*: investors *for* impact can commission independent feedback on the perceived effectiveness of their investment model and portfolio management practices.

- Investor *for* impact's *cost efficiency*: it is vital to track whether the investor *for* impact uses its resources efficiently.

IntoUniversity © Caroline Cornil

Measuring and managing impact

As the impact management process is a circular process, the investor *for* impact should go through its five steps more than once during the investment management phase, and should do so considering the investor level and the SPO level. Investors should also avoid burdening their investees with extremely complex and unnecessary requests related to IMM, considering that the resources of any SPO are limited and that decisions will have to be made about the amount of time and resources that each SPO will dedicate to IMM.

The setting of objectives (step 1) should be constantly revised and, if needed, modified throughout the investment management phase. The stakeholder analysis (step 2) may need to be repeated either at pre-defined intervals during the investment period or when significant developments occur. It is advisable to get back to the key stakeholders to verify whether their expectations are being met. Results of the progress of the SPO should be regularly measured (step 3) during the investment management phase. Some indicators may be reported by the SPO more frequently than others: output indicators can typically be captured more frequently than outcome indicators. Verifying and valuing results (step 4) should also be repeated as a 'reality check' at several points during the investment, in order to identify the impacts with the highest social value. Finally, investors *for* impact should monitor the impact (step 5), regularly assessing impact results against indicators and revising indicators if necessary.

Managing impact

Although the 5 steps of the IMM process should already have been planned and prepared during the other phases of the investment process, it is now that the framework is finally carried out. It is important for investors *for* impact not only to measure but also to manage impact. This means that investors *for* impact should continuously use the impact measurement process to identify and define corrective actions if the overall results deviate from expectations. Therefore, they have to adjust their process as lessons are learned, additional data is collected, and/or the feasibility of objectives is questioned.

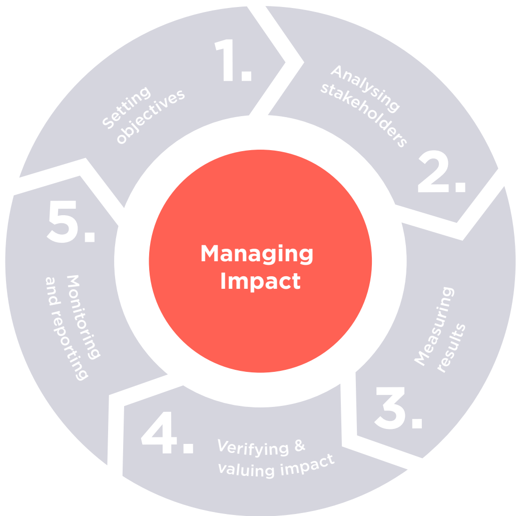

Figure 20: The EVPA five-step approach to IMM

Delivering non-financial support

Non-financial support

The investor *for* impact delivers non-financial support through a variety of delivery modes. Each delivery mode has its pros and cons, which need to be weighed before making a decision on how each type of non-financial support is to be delivered. The strategic factors that influence the delivery are the investment focus, the co-investment policy and the size of the investment.

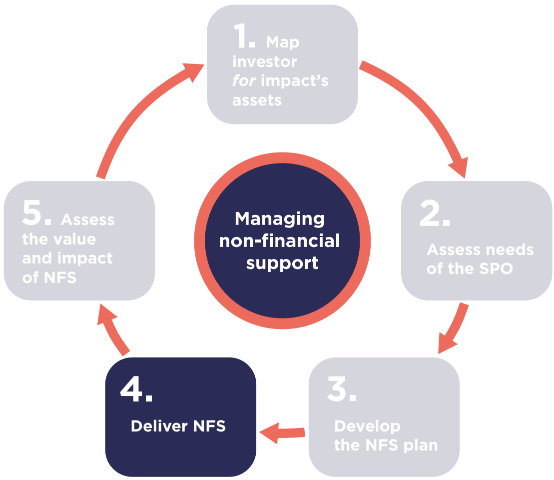

Figure 21: Step 4 of non-financial support

Delivery modes of non-financial support

- Taking a *seat on the board* of the investee.
- Providing *coaching and mentoring*.
- Organising *trainings, workshops and boot camps*.
- Taking the SPO to *conferences* and other external events.
- Offering *access to networks*.

Focus on the delivery mode: taking a seat on the SPO's board

It is a common practice among European investors *for* impact to take a seat on the SPO's board in at least some of their investments. This practice is especially extended amongst impact funds. Often, especially in start-ups, investors *for* impact take an active board seat that can almost be likened with co-entrepreneurship. In such cases, investors *for* impact do not manage, but are involved in all major decisions. Two key questions will drive the investors' preferences on board representation:

- Can the investor *for* impact really add value to the board and is it useful for the investor?
- Does the investor *for* impact have the capacity to do this?

The decision will often depend on the size of the investment and its importance within the investor's overall portfolio. In addition, investors *for* impact considering taking a board seat will need to think about how they will handle conflicts of interest (e.g. when re-investment is on the agenda). The investor *for* impact should try to anticipate such situations upfront and plan its approach accordingly. Using different people to take on the roles of portfolio manager and board representative can help. The EVPA Code of Conduct (introduced in section 1.5) can be useful when taking board seats.

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

Determining exit readiness

Exit readiness is defined as the moment in which the goals set by the SPO and the investor *for* impact have been reached, and/or the investor *for* impact cannot add any additional value and should exit. Although the VP approach involves a medium/long investment horizon and requires patient capital, there are concrete risks also in staying too long. On the one hand, the investee may become complacent as it knows it can always count on the financial support of the investor. On the other hand, the organisation investing *for* impact could be putting its financial and human resources to better use pursuing other, more impactful opportunities. For these reasons, determining exit readiness is a crucial step in the exit strategy process.

During step 3 of the exit strategy process, the investor *for* impact monitors the investment based on the exit plan co-developed with the investee. The SPO cooperates with the investor by providing information on the status of development of the project and the goals set in the plan. The monitoring is crucial, as it allows the investor and the SPO to act in case of deviations from the original exit plan. On the basis of the monitoring, the investor *for* impact and the SPO determine if exit readiness is reached relative to the planned date of exit. Once the SPO is "exit ready", the investor *for* impact needs to assess to which extent it is also "investment ready".

It is important that the SPO reaches the goals on all three dimensions because a strong, self-sustainable / financially viable organisation is the pre-requisite for the long-term achievement of the impact goals. The investor *for* impact also considers exit readiness from the perspective of its own social impact and financial return goals.

Artbox London © Caroline Cornil

The exit strategy process

When determining exit readiness, there are five possible scenarios:

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

2. Readiness is reached or partially reached, to the point that the investor *for* impact can no longer add value to the investee, but investment readiness is not reached. In this case, the investor can:

- Invest more resources to bridge the gap between exit readiness and investment readiness
- If there is no market for the SPO, let it go.

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

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

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

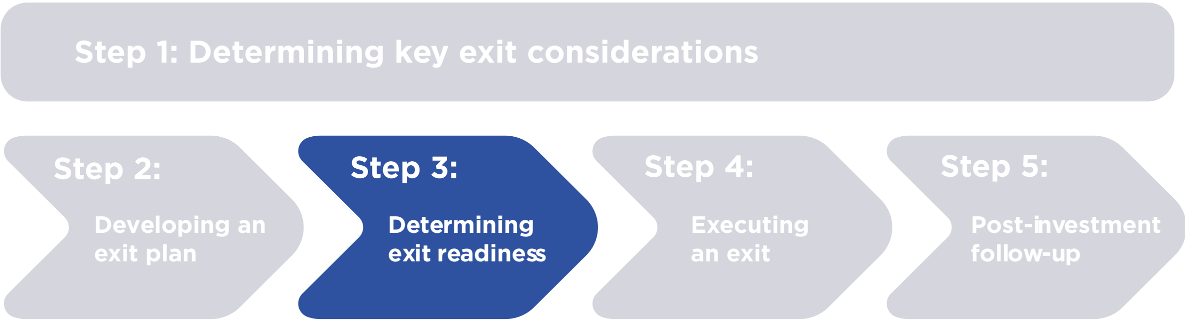

Figure 22: Step 3 of the exit strategy process

NEST © Joan Bardeletti

IV.

EXIT

Bednet © Lieven Van Assche

IV. EXIT

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

Starting from the investment strategy and during the investment process, the investor *for* impact should have started the exit strategy process by determining key exit considerations (step 1), developing an exit plan (step 2), and determining exit readiness (step 3). At the time of exit, step 4, which is the execution of the exit, and step 5, a final evaluation and follow-up activities, take place.

CHECKLIST

- Exit management
- Exit follow-up

1) Exit management

How to manage an exit, when it comes

Step 4 of the exit strategy process is the moment in which the exit strategy is executed in practice. At this stage, the investor *for* impact determines how to exit (mode of exit) and to whom to exit (follow-on investors), balancing the financial and social return.

The mode of exit depends on three main factors: the financial instrument deployed, the stage of development of the SPO and the context in which the SPO operates. Table 23 at page 105 overviews the main exit modes for each financial instrument used.

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

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

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

Follow-on investors can be foundations, impact funds, financial institutions, VC/PE investors, corporations, public funders, initial public offering (IPO), commercial investors, and others. For example, if the investee has generated track record and proven that it can generate financial returns alongside social impact, it is worth to look at, among others, investors *with* impact as potential follow-on investors (see section 2.7 at pages 57 and 58).

Modes of exit per financial instrument:

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

Figure 23: Modes of exit per financial instrument

The exit strategy process

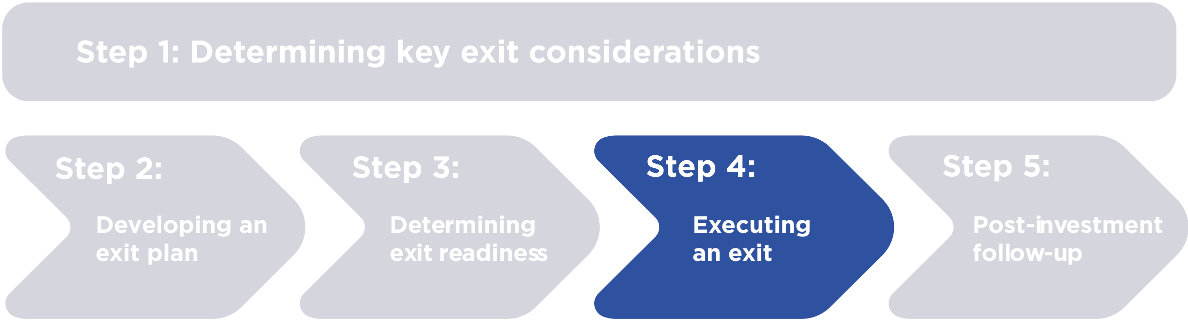

Figure 24: Step 4 of the exit strategy process

MyChild Solution © Nargis Rahimi and Shifo Foundation

2) Exit follow-up

How to perform a final evaluation of the investment

Final evaluation

Post-exit, there will also be an evaluation of the investment (degree of achievement of investor's and investee's objectives and learnings from the process), and potentially a post-investment follow-up. The final evaluation is essential because the lessons learnt will inform the exit strategy and the key exit considerations (i.e. step 1) for future investments.

The investor *for* impact evaluates the success of the project after exit in terms of financial and social returns, and the SPO determines how well it has achieved its objectives across the three dimensions of social impact, financial sustainability and organisational resilience. Particularly, the investor *for* impact should also evaluate how well it has succeeded in supporting the SPO in achieving its objectives.

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

As part of the final evaluation, the investor *for* impact should also measure how the investee perceives the value of the non-financial support provided, to understand its value.

The exit strategy process

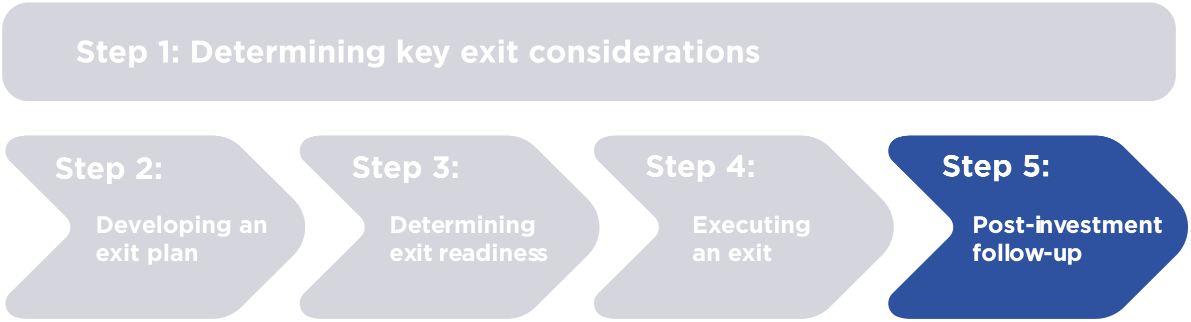

Figure 25: Step 5 of the exit strategy process

Non-financial support

As part of the post-exit evaluation, investors *for* impact develop mechanisms to assess the impact of the non-financial support they deliver to the social purpose organisation. In particular, they assess (i) whether the NFS provided helps the SPO achieve its objectives and (ii) how the SPO perceives the value of the NFS received. At this stage, engaging external, independent parties in the perception evaluations increases the chances of collecting reliable, unbiased opinions from SPOs.

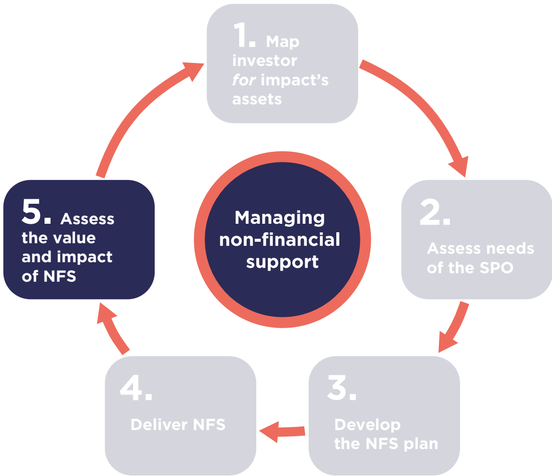

Figure 26: Step 5 of non-financial support

Follow-up activities

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

Don't forget...

At the post-exit stage, investors for impact perform a thorough analysis of the impact results against objectives – verifying and valuing reported results (step 4 of the IMM process explained at pages 72-73), as well as monitoring and reporting the impact (step 5 of the IMM process, defined at pages 82-83).

IntoUniversity © Liam Arthur

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The pictures displayed throughout this toolkit are retrieved from the EVPA **success stories**. These stories showcase how investors *for* impact have adopted the venture philanthropy approach to help SPOs create social impact.

Read the success stories at: https://stories.evpa.eu.com/

By order of appearance, the success stories displayed in this toolkit are:

- Callander Youth Project Trust – Inspiring Scotland
- Social-Bee – FASE
- Inspire2Care – Karuna Foundation
- Simplon – France Active
- IntoUniversity – Impetus
- NEST – Investisseurs & Partenaires
- Eau et Vie – Trafigura Foundation
- CottonConnect – C&A Foundation
- WARC – Cordaid Investment Management
- AfB – BonVenture
- Living Well with Dementia – Genio
- ROMANI Design – ERSTE Foundation
- Bednet – King Baudouin Foundation
- Artbox London – School for Social Entrepreneurs
- Shifo Foundation – IKARE

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The European Venture Philanthropy Association (EVPA)

Established in 2004, EVPA is a non-profit, membership association gathering organisations based in Europe and interested in or practicing venture philanthropy (VP). These include social impact funds, grant-making foundations, social investment crowdfunding platforms, corporate social investors, impact investing funds, private equity firms and professional service firms, philanthropy advisors, financial institutions or business schools. EVPA currently gathers 280+ members from 33 countries, mainly based in Europe.

EVPA defines VP as a high-engagement and long-term approach through which an investor *for* impact supports a social purpose organisation (SPO) to help it maximise its social impact.

EVPA is committed to support its members in their work by providing networking opportunities and facilitate learning. Furthermore, EVPA strengthens its role as a European thought leader in order to build a deeper understanding of the sector, promote the appropriate use of VP and voice the concerns and expectations of investors *for* impact to policy-makers.

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