



# ESTABLISHING A VENTURE PHILANTHROPY ORGANISATION IN EUROPE

## A PRACTICAL GUIDE

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# ESTABLISHING A VENTURE PHILANTHROPY ORGANISATION IN EUROPE

## A PRACTICAL GUIDE

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# EXECUTIVE SUMMARY

This is the second edition of a working paper that was first published in 2008. It is intended to capture and share the learning of a number of pioneer European venture philanthropy (VP) organisations, which were set up in the period from 2000-2004, when the VP “movement” first began in Europe. Its goal is to assist start-up or early-stage VP organisations (VPOs) in Europe by providing an insight into ‘what works’ in a European context, keeping in mind the diversity existing at individual country level. At the end of the document, there is a glossary that provides definitions of the key terms mentioned in the report.

This new edition takes into account the enhanced experience of existing VPOs, the emergence of new VPOs or new financing instruments and finally the material changes in the financial and economic climates in Europe and around the globe in the past years. Specifically, it highlights the following:

- The emergence of two interlinked but separate directions within venture philanthropy: the focus on social investment (investment, in social purpose organizations, that may generate a financial return, but whose primary purpose is to generate social impact) and the provision of grants to social purpose organisations with the aim of generating social return without the prospect of financial return (grant funding). New and sophisticated financing instruments are being developed in the spectrum between and including these two approaches by new and existing players.
- We also document further VPO experience in the spheres of managing/creating deal flow; follow-on funding; developing different vehicles; portfolio management; handling failed investments; developing performance measurement for the investments and for VPO organisations themselves and handling exits. These new experiences are included in this new edition.
- Material change in financial and economic climate that increases the challenges of attracting start-up funding; causes some new funders to seek a financial return; and has implications on public sector funding

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

- A high level of engagement, involving a hands-on approach to working with SPO investees
- Tailored financing using a variety of financial instruments (including grant-making)
- Multi-year support, typically three to five years
- Non-financial support to help SPOs build strategic and operational capacity
- Organisational capacity building rather than supporting individual projects
- An emphasis on performance measurement (at both SPO and VPO levels)

## EXECUTIVE SUMMARY

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VP is therefore most appropriate as a source of finance and support to SPOs that are seeking a 'step change' in their operations. For small-and-medium sized SPOs, this may mean replicating their operating model in new or more broadly defined markets. For larger, more established SPOs, VP funding may be appropriate in several settings that involve managing change, such as mergers and scaling up. VP is not necessarily appropriate for all SPOs. The VP industry seeks to complement existing forms of social finance and to contribute to the development of a more efficient capital market to support the social economy. Although VPOs initially adapted high-level principles from investment industry players such as venture capital funds, they have since developed specific investment tools, processes and methodologies that have been adapted to work effectively in the social sector. Venture philanthropists with roots in the commercial sphere have had to learn how to operate within the cultural and operational frameworks of the social economy.

### Setting up a VPO

The success of any new VPO will be driven by the **founder(s)**, who will define a vision and a set of objectives for the organisation. Founders typically come from either the world of private sector investment or from the social sector. A successful VPO needs to possess skills from each of these areas in-house. The founder therefore needs to attract the right start-up management team - particularly the right CEO - to build the organisation's knowledge and expertise. VPO management teams are often small at start-up – typically one to four people). Ideally, they should comprise open-minded individuals who share the founder's vision and passion for social change and who are willing to acquire new skills in what is a rapidly-evolving industry, characterised only recently by a move toward standardisation. Recruitment is often conducted within the founder's personal network – because of the lack of recognised professional norms within the VP sector and because of the personal disposition of many founders. Many successful entrepreneurs simply apply the same kind of hiring practices that they have followed in their commercial activities. However, remuneration levels in the VP sector are sometimes set at discount to the private sector, accounting for the 'social return' enjoyed by staff through their work and compensating through improved working conditions.

Consideration should be given to the type of **funding models** that will be applied. The main question to be answered is whether the VPO will work with instruments other than grants or focus on grant funding of target Social Purpose Organisations. In many European countries, tax and legal regulations distinguish between grant funding, and instruments that establish ownership titles, and the legal structure of the VPO has to take such regulations into account. A VPO's board can fulfil various roles, depending on needs. They are likely to have external duties, such as fund-raising and public relations, as well as internal obligations, such as providing expertise and support to the management team. At start-up, a VPO will typically have a small (three-to-five member) hands-on board, who engage actively with the management team. As decision-making and other processes become more established, the board may assign some of its duties (particularly investment decision-making) to a smaller sub-committee.

**Fund-raising** is a key challenge for any start-up VPO. It requires vision, clear communication, persistence, passion and optimism. The process will be made easier if the founder can commit some of his or her own capital to the VPO. Prospective funders are likely to fall within one of a number of categories, such as the founder's personal network,

existing trusts and foundations, high-net-worth individuals, corporates and government agencies. It is worth taking time to understand which investors will share the founder's vision, and approaching them accordingly. Due to the relative immaturity of VP, the founder will need to communicate the vision clearly to potential investors. They will often need to be introduced to the principles of VP and to be convinced of VP funding's great potential to deliver social impact. Having a high-calibre CEO in place and identifying a handful of initial high-quality SPO investments can help build credibility and encourage commitment from investors.

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

### Investment Strategy

The starting point for developing an investment strategy lies in a clear articulation of the VPO's objectives. This will encompass issues like sector and sub-sector focus, preferred models of intervention, preferred types of SPO, social impact targets and financial targets (if any). It can also include the development stage of the SPO (i.e. start-up /early stage/ more established organisations).

The preferences and requirements of the VPO's investors will determine the fund's term. Its 'tools of the trade' will also need to be defined, namely the financial instruments that will be used. VPOs can employ a wide range of instruments, including guarantees, loans of various levels of seniority, quasi-equity, equity and grants. The choice of instrument will be driven by the particular circumstances of the SPO and the investment. Instruments that require repayment, such as loans or quasi-equity investments, are best suited to income-generating SPOs.

Current VPOs typically have a small portfolio of investee SPOs (three to ten) in their portfolio, reflecting the high-engagement nature of the investments. The 'right' portfolio size will depend mainly on the size of the VPO, the average size of a single investment and the level of non-financial support offered. When deciding on the portfolio size, VPOs should also consider the optimal portfolio size required to create a network of dialogue and collaboration between the SPOs, thereby creating an opportunity for incremental impact.

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

### WHAT IS VP TO ME? A PERSONAL NOTE FROM AN INDUSTRY LEADER

"I believe the VP model is still developing and as long as the basic principles of capital, direct engagement and capacity building are followed, these models can be adapted quite easily to local culture and regulations. The VP model if executed properly by strong management teams working closely with social entrepreneurs, can produce very significant social impact. My own involvement has been as a supporter of 4 VP organisations, and as a Trustee of Impetus as well as the EVPA."

**Doug Miller**  
United Kingdom

## EXECUTIVE SUMMARY

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### **Deal Flow**

VPOs tend to take a proactive approach to identifying potential investee SPOs. It can be more focused and efficient than accepting open applications since VPOs target a very specific type of SPOs, and does not impose the administrative burdens associated with the latter approach. Potential organisations can be identified directly or via the VPO's own network (e.g., existing portfolio SPOs, other funders or co-investors) or through conferences or business plan competitions.

Leveraging the network of established investors and co-investors can be an excellent way of generating high-quality deal flow. This is especially important at start-up, when securing some early wins will be important (this may also necessitate an initial focus on lower-risk investments). Generating good deal flow will also require communicating the principles and benefits of VP to target SPOs, who may be unfamiliar with the concept.

### **Investment Appraisal**

Although terminology can vary among different VPOs, a VP investment appraisal typically involves three steps: first screening, detailed screening and investment proposal. First screening aims to identify SPOs with a good chance of securing investment. It involves a combination of desk research, to assess the strategic fit between VPO and SPO, and direct engagement with the SPO's management and board to strengthen the VPO's understanding of the organisation.

An organisation that has passed the first screen will generally build a business plan, as the 'output' to the detailed screening step. Typically this includes a review of the organisation's market, its three-to-five year strategy and operational plan, its social impact targets, a financial budget, an outline of its governance and organisational structures, and an assessment of its management and Board capability. Although the business plan should be seen to be 'owned' by the SPO, a VPO will often support its development, either directly or by providing third party consultancy support. The extent of the VPO's engagement with the SPO during investment appraisal generally, and during business planning specifically, depends on the VPO's preferred operational model and, in particular, the relative emphasis it places on providing support during the investment appraisal as opposed to during the actual investment phase.

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

### **Portfolio Management**

Various portfolio management options exist, including taking a board seat and arranging regular reports and reviews. Where possible, the form, frequency and purpose of engagement between VPO and SPO should be agreed and documented in an investment agreement. Engaging with individual SPOs during the investment phase can also extend to the provision of value-added services (see below).

In cases where investments do not succeed initially, the VPO should evaluate the reasons for failure and help investees to find solutions to problems where possible. VPOs should



avoid the temptation to simply throw money at the problem. Often, an SPO in difficulty may require non-financial assistance, such as staff coaching and even moral support for its leadership team. The most appropriate form of support will obviously depend on the specifics of a given situation.

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

### **Adding Value**

Adding value to investee SPOs can involve enhancing the organisation's capacity or understanding of its market, its strategy and operations or its governance and organisational structures. More specialised support may be required occasionally, in areas such as property management or the assessment of merger or franchising opportunities. The VPO can deliver this support directly or through external experts working pro bono, at reduced rates or on a fully commercial basis.

The purpose of any value-added support should be agreed in advance with the SPO. The focus should be on building the capacity of and the capabilities within the SPO, in order to enhance its long-term prospects and its self-sufficiency. VPOs need to be conscious of the perception that they are trying to impose their own agenda. Also, third party advisors should be selected only if they are sympathetic to the SPO's mission and can work effectively in the social sector. However, the VPO needs to decide on the level of intervention; for example, whether or not to take Board seats, how to manage underperformance versus plan, and how much to get involved in management changes. These considerations should be made both at the outset and subject to continuous review.

### **Performance Measurement**

Performance measurement is a key element of VP practice since it is critical to understanding and quantifying a VPO's social impact. However, measuring social impacts can be difficult, as they are often hard to quantify objectively. Furthermore, social impact measurement methods can vary greatly from one SPO to the next, which makes measurement at the portfolio level even more difficult. Although broad frameworks do exist, they will usually require a significant amount of customisation in order to reflect the particular circumstances of an SPO or a VPO's portfolio.

Quantitative data (e.g. number of people served, level of revenue growth) should be used to benchmark performance where possible. However, numerical information may not provide a complete picture. It can fail to provide a meaningful measure of outcomes, for example. Qualitative data, therefore, can be vital for capturing a full understanding of an SPO's activity. Frameworks, such as the theory of change model, and impact maps are often used as the basis for performance measurement at the SPO level. Methodologies also exist for fund-level performance measurement - most are derived from the social return on investment (SROI) model.

## EXECUTIVE SUMMARY

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### **Exit**

Exit occurs when the VPO's engagement with an SPO comes to an end. The approach to exit will vary based on the funding instrument used (grants versus other funding instruments) and the extent to which the SPO is financially self-sustaining. Financial exit by the VPO can create uncertainty, particularly for SPOs with little or no earned income or for those that have undergone significant growth during the period of the VPO's investment. Careful planning of the exit including preparation of the management and Board will be key to a successful exit. The VPO can help to maximise the SPO's chances of financial sustainability at exit in various ways: by discussing exit with the SPO early on (during investment appraisal); by using agreed performance measurement methodologies to define success and failure clearly; by helping the SPO to investigate additional revenue-generating opportunities; by helping the SPO to identify and secure alternative funding sources (including, where appropriate, public sector partners); and by assessing with the SPO any changes and strengthening in the management or Board. Depending on the profile of the next investor in line, for example if exiting to a commercial investor, issues such as potential social mission drift of the investee have to be taken into account.



PART 1

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# INTRODUCTION

## 1.1 PURPOSE OF THE DOCUMENT

This is the second edition of a working paper that intended to capture and share the early learning of a number of pioneer European venture philanthropy (VP) organisations, which were set up in the period from 2000-2004, when the VP “movement” first began in Europe. These VP organisations (VPOs) have since gone through the various stages in the lifecycle of a VPO and are now in a position to provide relevant advice to others. The paper is intended to assist start-up or early-stage VPOs in Europe by providing insights into ‘what works’ in a European context. It is a response to the widely published American experiences, which informed the early European VPOs. It shows, we hope, how we have taken that learning and made it our own, through innovating with and adapting American VP models to a European context.

The VP approach includes social investment and grant making best suited to support organisations seeking innovation and scale of impact by adopting a long-term, strategic view of growth. VP is not suited to a significant portion of the social sector market, for example community-oriented organisations working within relatively stable, unchanging environments. VPOs are usually interested in implementing a change process such as geographic expansion or transition to an income-generating SPO, in order to achieve a strong social impact.

Since this is an analysis that holds at a particular point in time, we have decided to produce a second edition to incorporate some of our most recent experiences. Specifically, we have witnessed the emergence of two interlinked but separate directions within venture philanthropy: the focus on social investment (investment, in social purpose organizations, that may generate a financial return, but whose primary purpose is to generate social impact) or grant funding of social purpose organisations with the aim of generating social impact without the prospect of generating a financial return (grant funding). Social investment includes a spectrum of increasingly sophisticated financing mechanisms which will be discussed in more detail in section 2.5.1. We have realized that grant funding and social investing require slightly different approaches, and, at times, different types of professionals. In this new edition of the report, we have highlighted where the differences lie.

We also document further VPO experience in the spheres of managing/creating deal flow; pursuing follow-on funding beyond the start-up phase; developing different vehicles (i.e. co-investing, specialist funds, etc); the greater need for portfolio management rather than just individual investee management due to increased portfolio size; handling difficult or failed investments; developing more active and deeper performance measurement for the investments and for VPO organisations themselves and a still limited number of examples of how to handle exits. These new experiences are included in this new edition.

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

The learning and recommendations set out here reflect our experiences as VP practitioners. This document is not intended as an academic paper. Rather, it is best considered as a milestone on a learning journey. We expect and hope that the content

VENTURE PHILANTHROPY  
PROVIDES A BLEND OF  
PERFORMANCE-BASED  
DEVELOPMENT FINANCE  
AND PROFESSIONAL  
SERVICES TO SOCIAL  
PURPOSE ORGANISATIONS –  
HELPING THEM TO EXPAND  
THEIR SOCIAL IMPACT.

### WHAT IS VP TO ME? A PERSONAL NOTE FROM AN INDUSTRY LEADER

“Coming from the venture capital world it is exciting to see many of the techniques that have been developed over the last 30 years being applied in the charity world. But it is also crucial that we learn from the charity world and respect its culture and values. Impetus Trust, the VP organisation I co-founded, sees itself as combining the best from the two worlds to achieve maximum social impact.”

**Stephen Dawson**  
United Kingdom

will date quickly, as the European venture philanthropy movement gains scale and momentum, and surpasses the experience documented here. Some of the views expressed here are shared across VPOs, Others are not. Where views diverge, we have tried to present several perspectives and outline the circumstances in which they may apply. In this second edition of the paper, we have tried to incorporate some of the comments we have received on the first edition. We envisage future editions of this document and continue to welcome your views and perspectives to grow the body of practice recorded here. Please email your comments to [info@evpa.eu.com](mailto:info@evpa.eu.com).

The first edition of the document was developed over a period of 12 months by an EVPA Working Group led by Luciano Balbo, Deirdre Mortell and Pieter Oostlander. Its content was informed by the experiences of the following funds – Fondazione Oltre (Italy), One Foundation (Ireland), Impetus (UK), Venturesome (UK), and Noaber Foundation (Netherlands). It was developed through a number of workshops to download learning, refined by the Working Group, and finally subjected to a peer review process. We would like to express our gratitude again to the members of the initial Working Group for their enthusiasm, time and energy, our peer reviewer Artur Taevere our editor, Cormac Sheridan, and project manager Ahmad Abu-el-ata. The changes to this second edition have been made by Deirdre Mortell, Pieter Oostlander and Lisa Hehenberger, Research Director of EVPA and peer reviewed by Luciano Balbo, David Carrington, Inês De Oliveira Magalhães and Nat Sloane.

## 1.2 ESSENCE AND ROLE OF VENTURE PHILANTHROPY

Venture philanthropy provides a blend of performance-based development finance and professional services to social purpose organisations – helping them to expand their social impact. This is a high-engagement, partnership approach, analogous to the practices of venture capital in building the commercial value of young companies. VP in its modern form developed originally in the US in the mid-1990s, took hold in the UK from 2002 and has since expanded is into continental Europe<sup>1</sup>.

### 1.2.1 Definition of Venture Philanthropy

There are several published definitions of venture philanthropy, which try to capture its essence and core practices. The definition adopted by the EVPA is set out below:

***Venture philanthropy works to build stronger social organisations by providing them with both financial and non-financial support in order to increase their social impact.*** The organisations supported may be charities, social enterprises or socially driven commercial businesses, with the precise organisational form subject to country-specific legal and cultural norms.

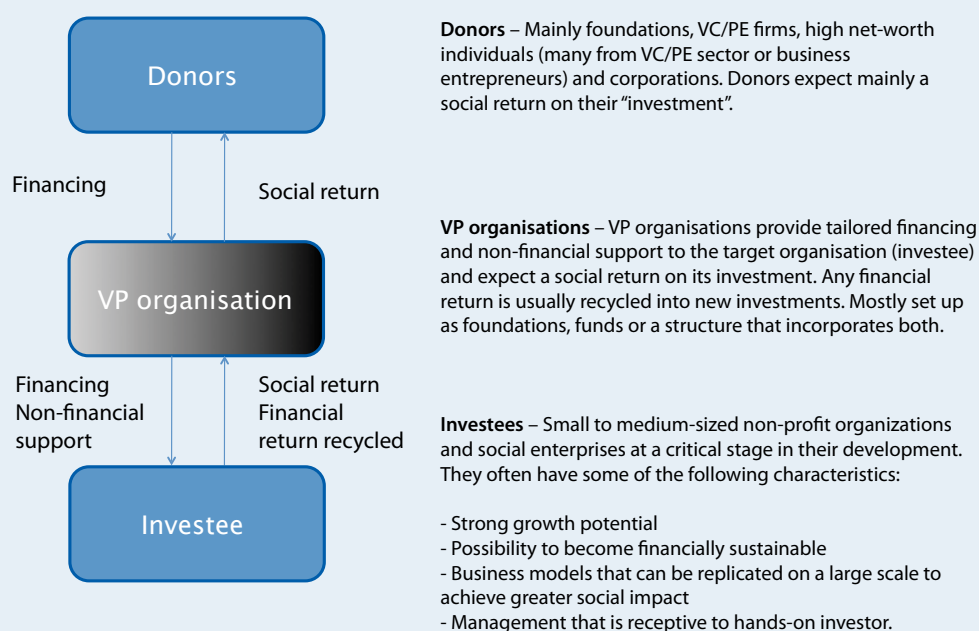
As venture philanthropy spreads globally, specific practices may be adapted to local conditions, yet it maintains a set of widely accepted, key characteristics. These are:

- **High engagement:** venture philanthropists have a close hands-on relationship with the social purpose organisation they support, driving innovative and scalable models of social change. Some may take board seats at these organisations, and all are more intimately involved at strategic and operational levels than in many other forms of philanthropy, significantly reducing the number of organisations supported to around 10-15 for the average VP organisation.

<sup>1</sup> John, R. (2006), “Venture Philanthropy: the evolution of high engagement philanthropy in Europe,” Skoll Centre for Social Entrepreneurship, Said Business School, University of Oxford.

- Tailored financing:** as in venture capital, venture philanthropists take an investment approach to determine the most appropriate financing for each organisation. Depending on their own missions and the ventures they choose to support, venture philanthropists can operate across the spectrum of investment returns. Some offer non-returnable grants (and thus accept a purely social return), while others use loan, mezzanine or quasi-equity finance (thus blending risk-adjusted financial and social returns).
- Multi-year support:** venture philanthropists provide substantial and sustained financial support to a limited number of organisations. Support typically lasts three to five years, although timescales may become longer as VP in Europe develops. The VPO's objectives will include helping the organisation to become financially self-sustaining by the end of the funding period.
- Non-financial support:** in addition to financial support, venture philanthropists provide value-added services such as strategic planning, marketing and communications, executive coaching, human resource advice and access to other networks and potential funders.
- Organisational capacity-building:** venture philanthropists focus on building the operational capacity and long-term viability of the organisations in their portfolios, rather than funding individual projects or programmes. They recognize the importance of funding core operating costs to help these organisations achieve greater social impact and operational efficiency.
- Performance measurement:** venture philanthropy investment is performance-based, placing emphasis on good business planning, measurable outcomes, achievement of milestones, and high levels of financial accountability and management competence.

### The Venture Philanthropy Approach



### 1.2.2 Origins and European expansion

The term 'venture philanthropy' can be traced back as far as the 1960s in the US, but it was only during the 1990s that the term gained popularity and stimulated a debate on new forms of highly engaged grant making by foundations. An influential Harvard Business Review paper by Letts, Ryan and Grossman<sup>2</sup> challenged foundations to employ tools from venture capital to invest in the organisational, rather than the programmatic, needs of social purpose organisations. Porter and Kramer<sup>3</sup> subsequently challenged foundations to create greater value and to act as more than a passive conduit for transferring finance from private sources to grantees. At the same time, existing foundations were considering how to change some of their practices in order to better assist the social sector and how to align their investments with their social mission. In the UK, considerable interest in innovations in social investment, including high engagement models, began to develop in 2001. While there were several historical examples of VP-like activity, it was not until 2002 that the UK's first VPO, Impetus Trust, was launched. In continental Europe, there has been a slow, but steady arousal of interest in social investment and high-engagement models of philanthropy, but only in the last four or five years have new organisations or models emerged. The EVPA, formed in 2004, is the primary vehicle for encouraging the development of the VP model throughout Europe.

Although not without its sceptics, VP has the potential to contribute to developing a more flexible and diverse social investment market. Its focus on building organisational capacity in entrepreneurial social purpose organisations, matching appropriate finance with strategic business-like advice, makes it a distinctive provider of capital. Venture philanthropy in Europe has strong links to the private equity and venture capital community, giving it opportunities to influence the corporate social responsibility of a set of major players in Europe's financial services industry. Several new venture philanthropy organisations have been established by philanthropists who had successful careers in private equity. However, foundations are increasingly interested in the VP approach as an additional tool in their philanthropy toolbox. EVPA has recently (October 2010) published a report on VP strategies for foundations<sup>4</sup>. Some foundations use selected parts of the VP approach in their everyday activities, others have set up dedicated VPOs within the foundation, and some foundations use VP as an alternative strategy calling for a complete turnaround. Co-investment between a VPO and a foundation is also an interesting strategy as it enables each party to contribute its own expertise. Foundations often have extensive experience of working in particular social sectors that can prove invaluable to a VPO that is more focused on developing processes and building strong organisations. VP in its current form is evolving at the intersection between the for-profit and the non-profit sector involving professionals and practices mainly from venture capital, philanthropy and the corporate sector.

The Central and Eastern European countries, the Baltic States and Former Soviet Union have faced significant challenges in rebuilding a market economy and a social sector simultaneously, leading to widespread, unaddressed social needs. VP may have a particularly valuable role in helping to build stronger civil society institutions in these countries. As evidenced in another EVPA publication - Social enterprise: From Definitions to Developments in Practice<sup>5</sup> - VPOs, both in transition economies and in more mature markets, often have to struggle with regulatory hurdles in their quest to provide social purpose organisations with the support necessary to prosper and grow.

<sup>2</sup> Letts, C., Ryan, W. and Grossman, A. (1997) "Virtuous Capital: What Foundations Can Learn from Venture Capitalists", Harvard Business Review

<sup>3</sup> Porter, M.E. and Kramer, M.R. (1999) "Philanthropy's New Agenda: Creating Value", Harvard Business Review

<sup>4</sup> Metz Cummings, A. and Hehenberger, L. (2010) "Strategies for Foundations: When, why and how to use Venture Philanthropy", EVPA Knowledge Centre Research Paper.

<sup>5</sup> Maretich, M. and Bolton, M. (2010) "Social enterprise: From Definitions to Developments in Practice", EVPA Knowledge Centre Research Paper



### 1.2.3 Motivation for Venture Philanthropy

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

Venture philanthropy is best described not as a blueprint, but rather as a movement that is evolving a set of practices. However, EVPA has recently decided to issue guidelines for practice and establish general principles in order to encourage the professionalization and standardization of the industry. The objective of the guidelines is to manage expectations as to the behaviour of VPOs.

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

- Communicating and marketing what they do within the social sector (to multiple audiences, including SPOs, statutory agencies, other types of social sector funders)
- Developing a range of financial instruments and advisory services that meet the needs of SPOs
- Measuring the performance and social impact of SPOs (and hence the performance of VP investment)
- Collaborating with and learning from complementary capital providers such as foundations or private equity and venture capital firms.

### 1.3 TARGETS OF VENTURE PHILANTHROPY

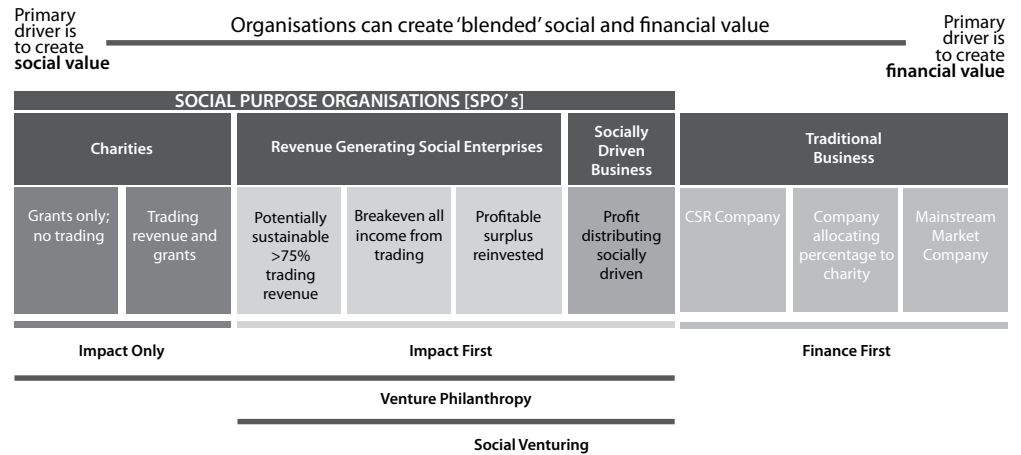
Venture philanthropy can operate across a spectrum of organisational types, from charities and non-profit organisations through to socially driven business. The diagram below<sup>6</sup> sets out the range of organisational types that may have some social mission of one form or another. Those that are typically considered for investment by VPOs will generally fall into the Charities, Revenue Generating Social Enterprise and Socially Driven Business categories, collectively referred to as Social Purpose Organisations (SPOs) in this paper:

#### WHAT IS VP TO ME? A PERSONAL NOTE FROM AN INDUSTRY LEADER

“Venture philanthropy is a new form of philanthropic giving combining the following features: A focus on few, young organisations with a high growth rate, extensive due diligence at the local level, tailored forms of financing as well as the provision of intellectual and social capital, a long-term commitment, ongoing monitoring and performance measurement and the optimization of social and environmental returns”.

**Wolfgang Hafenmayer**  
Switzerland

<sup>6</sup> Adapted from John Kingston, CAF Venturesome, by Pieter Oostlander, Shaerpa.



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

While the six key characteristics of venture philanthropy are included in the very definition of VP, a number of other factors define the specific strategic choices of a VPO in terms of where and how it will focus its efforts. Different VPOs will focus on different kinds of social purpose organisations, at different stages of their lifecycle. During recent years, VPOs have shown signs of increased specialization in terms of sector, geography and investee life cycle stage. This development comes from a growing recognition that VPOs can support their investees more efficiently by accumulating specific knowledge, and thus facilitating networking and knowledge sharing within their portfolios. The following table provides an overview of the characteristics of the targets of VP:

Target characteristic	Overview
1. Type of organisation supported	<ul style="list-style-type: none"> <li>▪ Most VP activity funds non-profit-distributing charitable organisations. Social enterprises and socially-directed for-profit businesses are also supported.</li> <li>▪ Most VP activity with organisations in the small to medium category (annual income between €400,000 - €5 million)</li> <li>▪ Likely to be an organisation led by highly capable, entrepreneurial individual. Some VPs wish to primarily back social entrepreneurs.</li> </ul>
2. Organisational stage	<ul style="list-style-type: none"> <li>▪ Venture philanthropists generally want to direct their resources to young, small-to-medium sized organisations with growth potential or to organisations that are at an inflection point such as scale up, merger or turnaround.</li> </ul>
3. Performance measurement	<ul style="list-style-type: none"> <li>▪ Still at an early stage of development for most VPOs. Several have developed relatively sophisticated performance metrics such as Balanced Scorecard™. VPOs describe their continuation of funding as performance-based, with the release of funds dependent on reaching pre-agreed milestones.</li> </ul>
4. Peer support and learning	<ul style="list-style-type: none"> <li>▪ VPOs work with a small portfolio of organisations, and several recognise the opportunities for mutual learning by bringing the portfolio together periodically. Such forums also provide a channel for delivering technical assistance to all portfolio organisations at once.</li> </ul>

## PART 1: INTRODUCTION

## KEY ISSUES AND LEARNINGS

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

## 1.4 GRANT FUNDING AND SOCIAL INVESTMENT - MAIN APPROCHES OF VENTURE PHILANTHROPY.

Venture philanthropy includes both grant funding and social investment. By grant funding we refer to the provision of non-repayable donations to the social purpose organization; an Impact Only strategy. Social investment (or social venturing) refers to funding that may generate a financial return, but where the social impact comes first; so-called Impact First strategies. Although grants can in theory be provided across the spectrum of SPOs, they are generally most suitable for SPOs that do not have the potential to become financially sustainable, i.e. Charities. In general, social investment is provided to SPOs in the categories of Revenue Generating Social Enterprises or Socially Driven Businesses, although loans can also be provided to Charities with trading revenues. The division between the two approaches is not as clear-cut as it may appear in this schematic overview. There is a spectrum of increasingly sophisticated financing mechanisms included in social investment, (see section 2.5.1).

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

- Considering the funding models that will be applied (2.1)
- Types of instruments (2.5.1)
- Exit (3.6)

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



## PART 2

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# KEY ISSUES FOR THE VP ORGANIZATION

This section addresses the major VP-specific issues that a VPO should consider.

Venture philanthropy shares a number of similarities with commercial venture capital. Traditional VC methodologies can be applicable in a VP context, particularly to investments in revenue-generating social enterprises and socially driven businesses.

However, several important distinctions remain:

- VP investments are assessed primarily in terms of social return (financial return will invariably be either zero or below-market) – this is inherently a more difficult indicator to quantify and assess.
- VPOs investing in revenue-generating social enterprises or socially driven businesses tend to have a higher appetite for financial risk than VC funds.
- Since the VP approach is still relatively new (especially from an SPO perspective), VPOs should incorporate a higher degree of flexibility and a longer timeframe into their investment decision-making processes than their VC counterparts.
- VP investments in revenue-generating social enterprises or socially driven businesses will often require a longer investment time horizon than in VC.
- Culture, perspectives and language differ across the two environments.
- There are operational differences in the set-up of investee organisations.
- Exit clearly has fundamentally different connotations for VP investments (see section 3.6).
- Although VPOs often seek board representation in the SPOs they invest in, the relationship is subtly different - governance rules and traditions require greater reliance on persuasion and trust than legal rights.

It is evident, therefore, that VC skills, systems and processes require a degree of adaptation in order to be applied within the social sector. The social purpose organisations supported often operate in difficult conditions and their success or failure may have implications on the lives and well-being of thousands of beneficiaries. VPOs must have empathy and consider that the ultimate goal of their activity is to generate social impact.

**IT IS EVIDENT THAT VC SKILLS, SYSTEMS AND PROCESSES MAY REQUIRE A DEGREE OF ADAPTATION IN ORDER TO BE APPLIED WITHIN THE SOCIAL SECTOR.**

## **2.1 CONSIDERING THE FUNDING MODELS THAT WILL BE APPLIED**

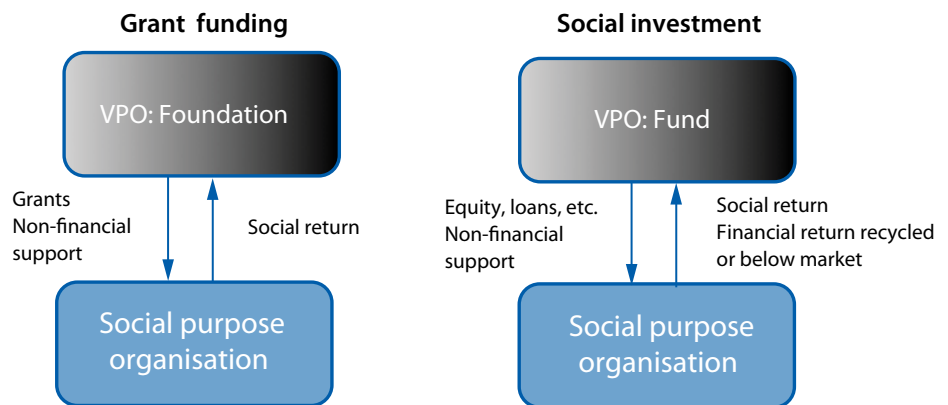
Before structuring the VP organisation, consideration should be given to the type of funding models that will be applied. The VP toolkit contains tailored funding as one of its key characteristics, and various types of instruments are available for funding, ranging from guarantees to grants (see section 2.5.1). The main question to be answered is whether the VPO will work with instruments other than grants or focus on grant funding of target Social Purpose Organisations. In many European countries, tax and legal regulations distinguish between grant funding, and instruments that establish ownership titles. Grant funding can usually be done from organisations with a charitable status. However, other types of funding could in various countries conflict with a charitable status despite the fact that the primary goal for those instruments, when applied by the VPO, is social as well. The choice of instruments made will in many cases impact the legal and tax structure of the VPO, and it is recommended to seek specialist advice before incorporation.

## PART 2: KEY ISSUES FOR THE VP ORGANIZATION

THE FOUNDER'S PERSONAL TRACK RECORD WILL BE CRITICAL, AND 'PUTTING THEIR MONEY WHERE THEIR MOUTH IS' WILL DEMONSTRATE COMMITMENT.

In general, when the primary activity of the VP organisation is to provide grants to social purpose organisations, "grant financing", it tends to be set up as a foundation. If the VP organisation mainly invests in social purpose organisations, "social investment" (using a spectrum of financing mechanisms, the primary goal being to generate social return), it is usually set up as a fund (or fund-like).

### Grant financing vs. Social investment



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

## 2.2 LAUNCHING A VPO

The founder(s) need to create the VPO's vision and articulate it to early partners – and then begin to build an understanding of and a plan for working within the VPO's areas of focus.

### 2.2.1 Founder(s)

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

VP has substantial potential, and has emerged from a movement to an industry. However, as an industry, VP still suffers from "liability of newness". Prospective donors therefore need clarity on the VPO's investment model and goals. The founder needs to articulate



clearly how the money will be invested; which areas will be prioritised; what the overall social impacts will be; and how the VPO will manage to achieve its goals. The founders also need to consider how the VPO will sustain itself over time. Founders need to be able to articulate early on the options for driving to sustainability. The founder's personal track record will be critical, and 'putting their money where their mouth is' will demonstrate commitment.

Founders typically come from one of the following backgrounds:

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

### 2.2.2 Preparing to work in the non-profit / social sector

A solid understanding of the social market is required, including:

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

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

THE VPO WILL NEED TO PAY CLOSE ATTENTION TO UNDERSTANDING THE ASPIRATIONS, PERSPECTIVES AND LANGUAGE OF ITS SPO PARTNERS, AND WILL NEED TO INVEST TIME IN COMMUNICATING ITS OWN GOALS AND ANALYTICAL PROCESSES CLEARLY.

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 PART 2: KEY ISSUES FOR THE VP ORGANIZATION
 

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THERE IS A NEED FOR A MIX BETWEEN SOCIAL AND PRIVATE SECTOR BACKGROUNDS. FINDING PEOPLE WHO ARE OPEN-MINDED AND WILLING TO LEARN NEW SKILLS AND NEW PERSPECTIVES FROM OTHERS IS ESSENTIAL.

### 2.3 MANAGEMENT TEAM AND BOARD

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

#### 2.3.1 The CEO and management team

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

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

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

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

Our collective wisdom tells us that a small team, typically one to four people, is the right number to start with. The profile could focus on people who are patient enough to understand how the social sector works, but who may not necessarily be from the social sector.<sup>7</sup> In general, there is a need for a mix between social and private sector backgrounds. Finding people who are open-minded and willing to learn new skills and new perspectives from others is essential.

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

It may be hard to attract the ideal candidate at the start. If it is necessary to compromise,

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<sup>7</sup> We found that if the fund is focused around social enterprise investments with revenue streams an investment perspective is critical, and this is typically not found among people from the social sector. However, people from social sector backgrounds are more critical among small teams investing in social-service or advocacy-type organisations, where earned revenue streams are not typically in place.

calibre and energy are preferable to directly relevant experience. It may be necessary to upgrade a particular post when the hire has demonstrated success. To date, management teams have often been sourced through networks. Professional searches and advertising can play a part, although the novelty of VP can make the latter a difficult proposition. Useful channels for recruitment include the jobs board offered on the EVPA web site, links to the career boards and events of EVPA's academic members to recruit business students.

Most successful VPOs in Europe have started with high-calibre teams that have significant experience – either held by the founders or gained through recruiting. If finance is a significant constraint, securing volunteer or pro bono support from professional service firms or other providers can be considered – but only if quality is maintained.

A deep knowledge of the social sector becomes critical quickly but is not absolutely essential at the start-up stage. People with investment backgrounds must have the flexibility and – importantly – the humility to gain a deep understanding of the key issues for the VPO to function effectively and maintain credibility with social sector partners. Finding board members or advisors from the social sector can enable this.

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

### 2.3.2 The board

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

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

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 who can provide the necessary time and who are personally committed to the success of the organisation. Donor representatives on the VPO Board are likely to represent the VPO externally,

PEOPLE WITH INVESTOR BACKGROUNDS MUST HAVE THE FLEXIBILITY AND – IMPORTANTLY – THE HUMILITY TO GAIN A DEEP UNDERSTANDING OF THE KEY ISSUES FOR THE FUND TO FUNCTION EFFECTIVELY AND MAINTAIN CREDIBILITY WITH SOCIAL SECTOR PARTNERS.

## PART 2: KEY ISSUES FOR THE VP ORGANIZATION

### IN THE SOCIAL SECTOR, THE PROVIDERS OF CAPITAL ARE DRIVEN BY A COMBINATION OF HEART AND HEAD.

including fund-raising activities and marketing, whereas Board members that are hired to bring specific skills and experience to the table will be the ones that tend to engage with the management team of the SPOs directly. During the start-up phase, when the VPO as a whole is in learning mode with respect to investment decision-making, the board is likely to act as the investment committee for final investment approval. Later, the board may feel that adequate decision-making processes have been established to allow for a smaller investment committee (e.g., a subset of the board) to take charge.

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

Inevitably, once the VPO is up and running, differences will emerge between the board and the executive management team over various aspects of the VPO's operation or investee SPOs, due to the deeper knowledge gained by the management team as they bed into their roles. The CEO, as the interface between the board and the management team, will play an important role in maintaining strong communications between the two groups and ensuring that their perspectives and expectations remain aligned. An interesting model is that of the Venture Partnership Foundation where each member of the board is connected to an organization as its primary contact. Fondazione CRT has also offered each board member a management role on the investment vehicles of its philanthropic investment fund.

#### 2.4 FUND-RAISING

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

Raising capital successfully from third parties requires:

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

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

This section will discuss both the sources and methodology for obtaining capital for a VP organisation.

##### 2.4.1 Start-up

Raising the initial capital is clearly difficult, since the idea of giving philanthropic capital

to an intermediary (one of the cornerstones of venture philanthropy) is new to many. It helps if the founder or founders can commit some of their own resources, to cover both capital needs and the operating costs. This not only helps financially, but also demonstrates their commitment to the project. The type of funds raised may influence the type of instruments that the VPO can ultimately offer (your investors will have their own preferences). This could mean that some potential investors may be more or less attractive targets, depending on the vision underlying the VPO. Potential sources of funding include:

- 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, of course, a matter of luck, but the prior business experience of the founders and their track record of success are important drivers.
- Trusts and foundations can be another source of capital. They generally make smaller grants to support projects, in comparison with VPOs. Promoting innovation can be an important motivation for these organisations, and they are thus most likely to support the first fund in a particular geographical area.
- Corporate sources (usually through their foundations) can be an important source of funding, and their language and thinking tend to be well-aligned with VP.
- High-net-worth individuals can sometimes be accessed through private banks. A VPO might attempt to build a long term relationship with the bank's philanthropic advisors by introducing them to the concept of VP and bringing them to an EVPA event. Many EVPA members are private banks and their advisory services department. Offering clients the opportunity to invest in VP can be a value-added services that banks offer to their clients. Government agencies will sometimes support efforts of this nature, in order to foster new ideas and to develop the social market. Be prepared, however, for a very long sales process and significant operating restrictions. In most cases, you will also need to bring in other investors to support the effort and to give your plan more credibility and independence.

Educating your potential supporters about both the methods and the benefits of VP investing is important. VPOs are relatively expensive to operate – in comparison with grant giving, for example - and it will take time to demonstrate how the investment activity will result in incremental social benefit.

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

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

- Be clear about your objectives
- Carefully target your potential investors and develop an understanding of why they would want to support you – remember each potential supporter will have different motivations

VPOs ARE RELATIVELY EXPENSIVE TO OPERATE AND IT WILL TAKE TIME TO DEMONSTRATE HOW THE INVESTMENT ACTIVITY WILL RESULT IN INCREMENTAL SOCIAL BENEFIT.

## PART 2: KEY ISSUES FOR THE VP ORGANIZATION

**WHAT IS VP TO ME?  
A PERSONAL NOTE FROM AN  
INDUSTRY LEADER**

“Venture Philanthropy blends the skills and networks of business with the passion and creativity of voluntary organisations to create a powerful recipe for impact on causes that we all care about. One Foundation came to this model from the parallel experiences of a frustrated philanthropist and a frustrated voluntary sector leader, and it intuitively addressed the frustrations of us both.”

**Deirdre Mortell**  
Ireland

- Anticipate the difficult questions and think through how you can respond credibly
- Find an early-stage lead sponsor – see if you can identify a foundation, financial institution, high-net-worth individual or other entity with a strong funding base. This will give you more capital and more credibility as you develop your operation.
- Be prepared for a major effort – appreciate that the majority of the people you speak to will say no – learn from those rejections and adjust your approach as necessary
- Be optimistic and persistent

**2.4.2 Follow-on funds**

Follow-on funds ideally should not be raised until several years after start-up, so that you can point to the results achieved with the prior fund(s). In practice, however, you will probably have to fund-raise constantly. The pioneer VPOs in Europe are currently facing the challenge of raising their second funds. The advantage of raising the second fund is that there should be an established team, an established portfolio of investments (typically around four to seven) and some evidence to support the thesis that your intervention has made a positive impact. Without these elements, a VPO is still essentially a startup. Once these milestones have been achieved, the fund-raising pitch can be based around the progress that has been attained and should facilitate the fund-raising process. However, moving from the start-up to the follow-on phase can be difficult. Some supporters will be more animated by the excitement of a start-up and the opportunity of investing in a new concept. Moreover, the founders may have exhausted the appetite of their immediate network and have to start ‘cold calling’.

The profile of investors second or third time round is broadly similar to that of the funders that were targeted initially, but, depending on the strength of the investment case, they may offer a better reception. Other things to consider:

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

**2.4.3 Other methods of raising capital**

Identifying and structuring an investment and then finding co-investors is an efficient way of using capital - this is discussed further in section 2.4.5.

Structuring investments to have some return cash flow (e.g., via recoverable loans) for those non-profits that can generate cash is also effective and helps VPOs to recycle some of their money

Although it is not strictly part of the fund-raising process, actively considering future investors for portfolio organisations should be an ongoing activity. It is particularly important when a VPO’s support is coming to an end. However, given the time horizons



involved in securing investment, the activity should begin shortly after – if not even before – the initial investment.

## 2.5 INVESTMENT STRATEGY

A VPO's investment strategy will flow from a set of choices that determine its focus and its objectives. These raise some obvious questions:

- What is the VPO's social objective? For example:
  - Achieving a specific social outcome
  - Promoting a certain model of thinking or working
  - Achieving systems change, so that entrenched problems can be effectively addressed

Each of these alternatives would influence the type of SPOs that will be supported

- What level of social impact does the VPO want to achieve?
  - Social impact should be quantified as much as possible (see section 3.5) - both the SPOs' impact and the VPOs' impact on the SPO
  - How social impact is quantified can determine the type of investments made and the requirements imposed on SPO investees
- Will the VPO utilize other funding instruments than grants? The decision to apply investment instruments that establish an ownership title (like loans and equity type funding) will influence the structure of the VPO (see paragraph 2.1). If so,
- What, if any, are the VPO's financial objectives? Are they independent of or secondary to the social objectives? There can be several reasons for setting financial 'co-objectives':
  - Achieving sustainability for the social initiatives supported by the VPO. Demanding a financial return will encourage the SPO to think stronger about "renewable" sources of funding.
  - Covering the VPO's management costs
  - Extending the lifetime of the VPO as much as possible by recycling financial returns from the investments, or even establishing a revolving fund. In this case, careful considerations should be given to the impact on the VPOs' policy. The wish to extend the lifetime or even establish a revolving fund may put undesirable pressure on the portfolio SPOs and could jeopardize the social returns.
- Will the VPO focus on charities only, or will it invest in social enterprises as well?

### 2.5.1 Types of instruments

Philanthropy emerged initially as the transfer of cash or other assets in the form of a grant. More recently, its definition has broadened to include any type of support where the goal is to achieve a social objective / social return and the financial return is non-existent or below-market. VP funding instruments are broadly similar to those used in the commercial sphere. The VP toolset as compared to the commercial one contains as additional

THE KEY IN VENTURE PHILANTHROPY IS TO SELECT THE TOOL THAT OFFERS THE BEST FIT. THE BUSINESS CASE OF THE SPO, RATHER THAN THE VP FUND'S PREFERENCES, SHOULD BE THE PRIMARY DETERMINANT.

## PART 2: KEY ISSUES FOR THE VP ORGANIZATION

**WHAT IS VP TO ME?  
A PERSONAL NOTE FROM AN  
INDUSTRY LEADER**

“Venture philanthropy is about making money work harder. Venturesome uses a recycling model, achieving nine hits with the money rather than the one-off grant. We also bring our experience and contacts to bear to add value to the organisations we invest in.”

**John Kingston**  
United Kingdom

instruments the grant and grant related funding instruments. The available funding instruments for a VPO cover the entire financial spectrum, ranging from guarantee to grants whereas many other forms of philanthropy focus on the grant.

- 1. Guarantee:** The SPO can be supported with bank loans guaranteed by the VPO. The VPO in this case does not need to supply cash upfront, but it opens up access to regular funding sources by taking on some or all of the risk that the lender would otherwise incur.
- 2. Senior loan:** The VPO can provide a loan secured with some of the assets of the SPO, under terms that would normally not satisfy the security requirements of a commercial lender. Loans, in general, are best suited to SPOs that can offer repayment through some form of earned income. In the absence of earned income however, an asset-backed loan could be provided, where the security would support the repayment of the principal only.
- 3. Loan:** A VPO can also provide an unsecured loan to the SPO, charging interest at or below market rates. The loan may carry a risk that exceeds what is usually acceptable for a commercial lender, or the normal commercial terms may be too onerous for the SPO. A variation to this instrument is a loan with a social performance-related interest rate. When certain defined social targets are met, a discount on the interest rate will apply. Or, if variable, the higher the social return, the lower the interest rate would be.
- 4. Sub-ordinated loan:** As above, but with a lower repayment priority ranking in relation to regular loans and other forms of debt (this may mean higher interest charges, if market rates apply, to reflect the higher risk).
- 5. Convertible loan:** unsecured loan or subordinated loan as above, with the option (either to the debtor or the lender) to convert into equity stake. This option to convert may be exercised by the VPO when financial return perspectives unexpectedly rise, thus offering the opportunity to generate additional return on the investment by owning an equity stake with upward potential rather than a loan with limited financial gains. Alternatively this instrument can be used in situations where the prospect of loan repayment may drop below earlier expectations, hence offering the SPO a possibility to get rid of a liability and convert it into a form of funding that cannot be reclaimed.
- 6. Mezzanine finance** (also known as **quasi-equity**): This involves the provision of a high-risk loan, repayment of which depends on the financial success of the SPO. This instrument bridges the gap between debt and equity/grant though some form of revenue participation. Examples include a loan that is only repayable through royalties based on the future sales of a product or service; or a royalty-sharing agreement that can be activated once an agreed profitability threshold has been reached. These instruments can offer an appropriate balance of risk and return.
- 7. Equity:** A VPO may opt to acquire part of an SPO's business. This can be appropriate when the prospect of a loan repayment is low or non-existent. It holds out the possibility of a financial return in the form of dividend payments. In addition, it allows for the possibility of a transfer of ownership to other funders in the future. Various initiatives are exploring the possibilities of establishing an exchange market to facilitate the transfer of such shares (e.g. Social Stock Exchange initiative in the UK<sup>8</sup> and the NeXii initiative in South Africa<sup>9</sup>).

<sup>8</sup> The idea of a 'social stock exchange' is being explored in the UK – and in Singapore, South Africa, the USA and Europe – with the support of the Rockefeller Foundation and some family offices including Halloran Philanthropies. For more information, see “Bring on the social stock exchange”, Marc Campanale, Alliance Magazine (June 2010)

<sup>9</sup> Nexus for impact investing (NeXii) is a result of the work of the GreaterGood South Africa group including the South Africa Social Investment Exchange (SASIX) and its related social enterprise, **CSR Systems Pty Ltd**. US-based Global Alternative Trading Engine (GATE) is a founding investor and provides the critical technology behind the transactions platform.



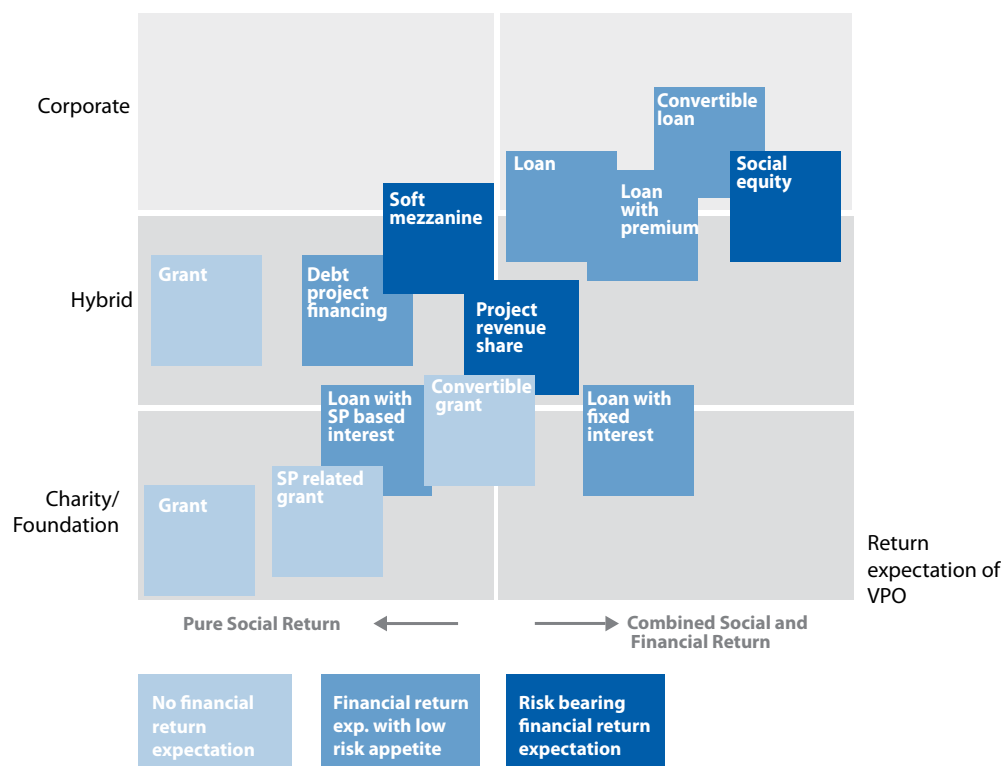
**8. Convertible grant:** Funding in the form of a grant with the option to obtain a royalty or a dividend, an equity stake in the SPO, or full repayment of the grant in case the SPO appears to be financially successful.

**9. Grant:** Funding in the form of a cash allocation that does not establish rights to repayments or any other financial returns.

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

VPOS HAVE SMALL PORTFOLIOS – TYPICALLY OF THREE TO TEN ORGANISATIONS – AND MAINTAIN ACTIVE RELATIONSHIPS WITH EACH OF THEM.

**Organisational structure of SPO**



The diagram above<sup>10</sup> pictures the organisational structure of the SPO on one axis and the return expectations of the VP Organisation on the other axis. In the left-hand bottom corner, if the SPO is a purely charitable organisation with no possibilities of generating income and lacking securitable assets, the funder should only use grants or grant related instruments, without expecting any financial returns. In the right-hand top corner, the funder invests in the equity of a hybrid or corporate, expecting a social as well as a financial return.

<sup>10</sup> Elaborated by shaerpa.

## PART 2: KEY ISSUES FOR THE VP ORGANIZATION

## KEY ISSUES AND LEARNINGS

- **Is VP just like VC?** VP is an emerging practice that has some parallels in the private sector world. While skills, methodologies and processes are transferrable (especially for VPOs that invest in revenue-generating social enterprises or socially driven businesses), adaptation is necessary for successful application in the social sector.
- **Role of the founder(s) - The founder(s) of the VPO is the key visionary of the project and must communicate that vision to attract early interest from others. They must also start to map out the critical internal knowledge and expertise the fund will need to focus effectively on specific social sectors or issues.**

Continued opposite

Some SPOs may be hesitant to work with funding mechanisms other than grants because they perceive them as risky or simply confusing. Grants can be used in situations that overlap with other types of financing. These situations can be locally specific (to the funding market in a particular country for example) as well as specific to the solution provided by the investment and to the length of time needed to solve the problem. Grants are particularly well suited to situations where the possibility of generating earned income is highly unlikely, undesirable or difficult to achieve within the investment horizon of the VPO. Large scale systemic change processes that attempt to alter an entire sector may require 10 years or more before generating revenue and would therefore require grant funding rather than other types of funding instruments. Furthermore, grants or grant related instruments will be preferable when earned income of the recipient organisation is anticipated to be insufficient to cover expense budgets, and in the absence of securitable assets.

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

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

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

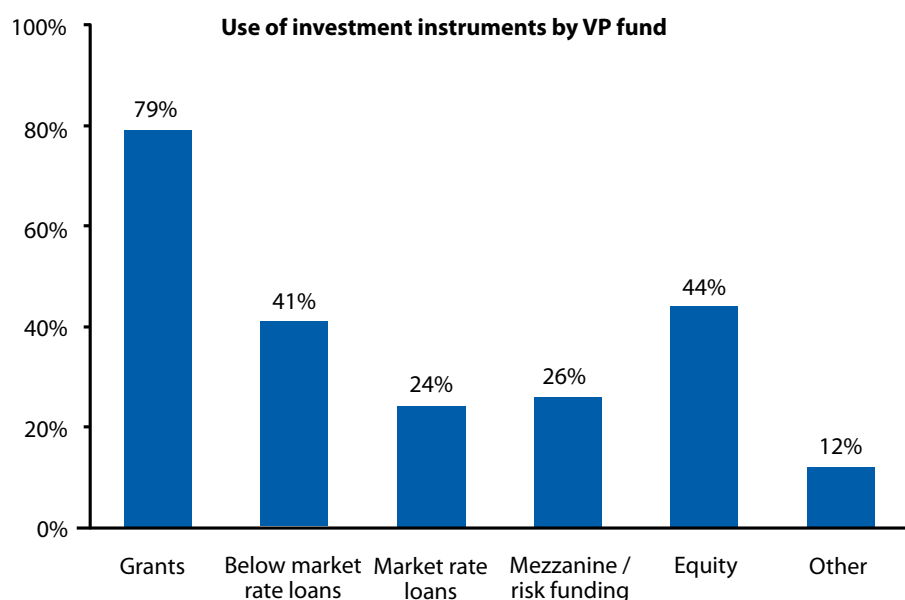
One should bear in mind that non-grant instruments have limitations, as they imply some level of income generation. Repaying a loan from third party grants or donations may not be acceptable. Moreover, they can also give rise to conflicts between social and financial objectives. Striking a balance between the two may not be easy, as a report sponsored by Charities Aid Foundation<sup>11</sup> outlines.

A survey<sup>12</sup> of mainly European VP shows that *"the vast majority (79%) [of European VPOs] use non-returnable grants, but a surprising number are willing and able to deploy debt or equity instruments depending on the nature and capital structure of the SPO being supported. This illustrates the way in which venture philanthropy is relatively blind to the boundaries between grant-making and social investment, as noted in the first Skoll working paper. While social investment is in its infancy in many European countries outside of the UK, there were VPOs using debt and equity instruments within the survey sample that were located in central/eastern Europe, Germany, Italy, The Netherlands, France, Ireland and the UK."*

<sup>11</sup> Russell, L. and Scott, D. (2007) "Social Enterprise in Practice - Developmental Stories from the Voluntary and Community Sectors", Charities Aid Foundation

<sup>12</sup> John, R. (2007), "Beyond the Cheque: how venture philanthropists add value," Skoll Centre for Social Entrepreneurship, Saïd Business School, University of Oxford. (n = 34; European VPOs surveyed = 32; American = 1; Australian = 1)

In contrast, the Morino Institute surveys from 2002 (Venture Philanthropy Partners, 2002) assume that most, if not all, of the US VPOs it surveyed used grants rather than loans or other forms of finance. The trend in VP in Europe is for VPOs to embrace a wider variety of financing mechanisms, although many are still limited to grants. Most VPOs offer either grant funding or other financial instruments, with a few exceptions that have a mixed structure, including Noaber Foundation and BonVenture.



### 2.5.2 Size of portfolio

A defining characteristic of VPOs, compared to more traditional grant-makers, is the relatively small size of the portfolio of organisations being actively supported at any time. Most grant-makers have large portfolios (typically tens or hundreds) of grant recipients. The relationship between donor and recipient is quite passive and unengaged. In contrast, VPOs have small portfolios – typically of three to ten organisations – and maintain active relationships with each of them. VPOs will also be guided by the need to have a minimum number of investments to provide a sufficient spread in terms of investment risk and to demonstrate that its investment model works in a variety of situations.

The portfolio size will be determined by the size of the VPO, the average size of the target organisations and the average level of support needed (taking into account the need to avoid financial dependency).

However, there are other factors to consider:

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

- **Role of management team and board - The CEO hire is the most critical move** the VPO will make. The makeup of the management team and board should reflect the needs of the VPO in terms of skills and knowledge. There is a delicate balance to strike between social sector experience and investment management skills. The board is likely to need to take on a more hands-on approach to supporting the management team in the start up phase.
- **Fund-raising - Successful fund-raising requires an ability on the part of the founder(s) to articulate a compelling vision** for the VPO and to communicate to investors the potential level of social impact that VP can achieve. The founder’s ability to provide some capital is often critical to success.
- **Clear focus - The VPO needs to be clear at the outset about its objectives** and its operating model. What areas of social need will it address? What types of organisations will it invest in? What types of financial instrument will it use?
- **Role of financial instruments - Carefully selecting and applying the right funding instrument** for a given organisation is part of the ‘art’ of VP investing

### 2.5.3 Social sector choices

Many of the pioneer VPOs focused on demonstrating the VP model rather than on targeting a particular social sector. Having a broad-based portfolio allows a start-up VPO to appeal to a wide variety of stakeholders. VPOs operating in a small market where the social sector is still undeveloped may not be able to afford to focus on one sector as deal flow would be too limited. However, as the VP industry becomes more established, many VPOs have started to focus on one or several social sectors, recognizing the importance of sector-specific knowledge to better assist their investees and to leverage the VPOs' resources. Such a focus makes sense because the VPOs can bring more added value in the areas where they develop a learning curve. Measuring impact is also facilitated by a clear investment focus on one particular social sector. Social welfare, children and youth, and education are the sectors that have received most attention by European VPOs.

An example of increasing sector focus is the launch of a specialist VPO focused on reducing reoffending in the UK. The VPO is a co-investment partnership between Impetus Trust, Esmée Fairbairn Foundation, Indigo Trust, Henry Smith Charity, and J Paul Getty Jnr Charitable Trust<sup>13</sup>. The initiative aims to bring a wide variety of experience together to tackle the many aspects involved in reducing reoffending in the UK, which currently costs the government over £18bn annually<sup>14</sup>. This new approach, set over a ten year time horizon, aims to create systemic change, tackling the context of the social problem, not only curing its symptoms. Impetus Trust acts as the lead investor, utilizing its strengths to conduct due diligence and provide supportive development assistance to investees. Apart from funding, the foundations bring knowledge of the criminal justice sector and the organizations that work within it.

### 2.5.4 Geographic choices

VPOs that adopt an international focus face additional costs and management complexities in comparison with those operating within a single national jurisdiction. Engaged portfolio management is obviously more complicated if the investee organisations are dispersed across several countries, while the development of an overseas network is necessary to maintain deal flow. Travel, legal advice and taxation advice will all impose additional costs.

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

### 2.5.5 Co-investing

Co-investment can be an important part of a VPO's investment strategy. It represents an excellent way of raising funds for VP activities – and may be easier than raising funds for the VPO itself. In addition, it can help to promote VP among a wider audience. It also eliminates the 'blind pool' element, whereby investors are asked to fund unidentified

<sup>13</sup> Impetus Trust (2010), <http://www.impetus.org.uk/what's-special-about-impetus/we-focus-on-poverty/impetus-for-reducing-reoffending-initiative> (Accessed June 2010)

<sup>14</sup> Ibid

organisations. It can help VPOs to target suitable trusts and foundations that are appropriate for a given investment. Co-investing does prompt certain cost considerations. Some VPOs may wish to charge co-investors a fee for managing the investment – to share overheads. This can often be a difficult negotiation.

As with the SPO, it is important to agree roles and responsibilities among co-investors up front. Although co-investors who add value are a definite plus, managing the consortium is easier if there is one active lead investor – usually the VPO - and a syndicate of other investors that are mainly passive. Other aspects of the relationship should also be agreed upon:

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

<b>CO-INVESTMENT</b>	
<b>Pros</b>	<b>Cons</b>
<ul style="list-style-type: none"> <li>▪ More funds available for target organisations; VPO may invest in more organisations</li> <li>▪ Spreading risk</li> <li>▪ Additional validation of the investment opportunity</li> <li>▪ Shared risk in case of failure</li> <li>▪ Shared risk should additional funding be required</li> <li>▪ Target organisation is not totally dependent on one funding source</li> <li>▪ Mitigate possible lack of deal flow</li> <li>▪ Co-investors can add specific skills, for example, many foundations have deep knowledge of specific social sectors</li> <li>▪ Reduce demands (reporting, etc.) on the SPO if lead investor manages relationship</li> <li>▪ May increase the reputation of the SPO through multiple investment partners</li> </ul>	<ul style="list-style-type: none"> <li>▪ Additional liability for VPO management organisation if co-funders lean on the work of VPO</li> <li>▪ Fund management cost ratios may increase since the same support organisation (VP management team) is managing a significantly larger portfolio – if co-investors do not contribute to management costs</li> <li>▪ Potentially more time-consuming for VPO and the investee in terms of reporting and relationship management issues</li> <li>▪ Potentially slower decision-making</li> <li>▪ VPO may have to sacrifice independence</li> </ul>

## PART 3

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# THE INVESTMENT PROCESS

### 3.1 DEAL FLOW

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

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

1. Good marketing channels for the VPO to broadcast its process;
2. A fairly mature SPO market where organisations will be open to respond to a gated process;
3. A well branded VPO, with an existing track record

There are many ways of identifying potential investment targets:

- Through existing portfolio organisations (these can be the best source)
- Networking with intermediaries, other funders, and, in particular, potential co-investors with a deep knowledge of the field of interest (these can be the second best source)
- Speaking at sector-specific conferences (innovative approaches arouse interest)
- VC funds that have dropped high-risk deals, which could be of interest (this is particularly relevant if your VPO focuses on social enterprise investments)
- SPOs operating projects within the focus area of the VPO (this is relevant if your VPO has a sector or geographic focus)
- Business plan competitions (also more relevant to social enterprise)

In addition to attracting deal flow, your VPO needs to define clearly the type(s) of investments you are looking for, as well as the selection criteria and the application process you employ. Several other measures can help to optimise deal flow:

- In the beginning, aim for quick wins by choosing low-risk deals. Some early success stories can help to secure financing. Deals that offer higher levels of social return will more likely flow once a robust, high-quality portfolio is in place.
- Working with a small group of aligned co-investors will significantly improve the quality of your deal flow. These may be foundations or trusts, other individual

GENERATING HIGH-QUALITY DEAL FLOW IS ONE OF THE MOST IMPORTANT CHALLENGES A VP FUND WILL FACE. IT SHOULD RECEIVE THE SAME LEVEL OF PRIORITY AS FUND-RAISING.

## PART 3: THE INVESTMENT PROCESS

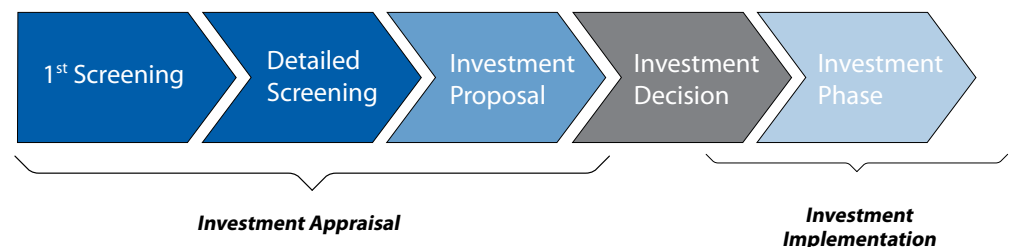
CLARITY AND OPENNESS DURING THE DUE DILIGENCE PROCESS ARE IMPORTANT TO ENABLE THE VP FUND'S TEAM TO DEVELOP A COMPLETE PICTURE OF THE SPO'S LEADERSHIP.

philanthropists, or a corporate or even a state funder. If the co-investors are older than your VPO, they will have an existing pipeline, relationships and market knowledge, all of which can save you time. However, be specific about what you are interested in and what you are not interested in. Make a 'what-my-fund-will-not-invest-in' list and circulate it widely.

- Casting the net widely (e.g., by publishing information and application forms on the web) may trigger many applications, but they may not be of the right quality. If you do communicate through the web about the projects you prefer to do, it is advisable to also communicate the type of projects you definitely **do not do**.
- Don't be afraid to focus on organisations that you already know.
- Develop a clear positioning around your VPO's value-added services – and articulate this very clearly to SPOs. You will need to differentiate yourself from all other funding sources, including other philanthropies, state and corporate funders.
- Select your marketing channels (but remember that word of mouth is the most powerful channel of all):
  - Website / web links / annual report of the VPO / publications / conference presentations, etc.
  - Current investees
- Rejected applicants – if they have had a positive experience and have received some added value, they will refer you on to others (clearly communicating positive feedback and constructive criticism arising from due diligence can represent tremendous added value for an SPO; so can a referral by you to another funder)
- Provide a case example of an ideal investment, and include a "what we won't invest in" list on your website.

### 3.2 INVESTMENT APPRAISAL

Different players employ differing terminology for the investment appraisal process. However, the key elements of the process are often similar and follow certain key steps:



The relationships that develop between a VPO's management team and the leadership of an investment candidate are important factors in the investment appraisal process, as the judgement of the management team is the key influence on a given investment decision. That judgement will, in turn, be based on the team's trust and belief in the



SPO's leadership. Clarity and openness during the due diligence process are therefore important, to enable the VPO's team to develop a complete picture of the SPO's leadership and vice-versa.

The appraisal process will incorporate, in some form or another, the following major steps:

- A knock-out screening step for applicants who do not meet the standard application criteria. This will eliminate organisations that will definitely not secure funding. This is a preliminary screening procedure – it requires initial application documents only.
- First screen (see below)
- Detailed screen (see below)
- Detailed investment proposal presented to the investment committee for final investment decision

Throughout the process, and especially during the detailed screen, communication and interaction with the potential investee SPO will help to make an assessment of the quality of the leadership (non-profit CEO, social entrepreneur, etc.) and the executive team, enabling the VPO to build trust and confidence in the SPO's ability to deliver during the investment phase. That engagement will help to answer certain key questions:

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

The quality of the SPO's leadership is likely to be addressed in the investment proposal and will be discussed by the investment committee.

A VPO should consider undertaking stepped investments<sup>15</sup> in target SPOs. The VPO 'can test the water' with new organisations by completing small investments initially:

- This can limit risk and minimize failure.
- Seeding multiple SPOs through small investments or donations can allow a fund to harvest the best deals eventually, after an engaged monitoring process.
- It is advisable for the VPO to be aware of the time required by the SPO to undergo investment appraisal, and to ensure that the time used at each screening stage is proportionate to the potential benefit. While this is guesswork for a start up fund, it can be established through independent investee feedback for more mature funds<sup>16</sup>.

Managing negative decisions is an important part of the investment process. The VPO should build in several evaluation and decision-making steps within the overall appraisal process, so that it can, where necessary, refuse funding at an early stage. The applicant should be made aware of each step in the decision-making process, and the key criteria considered at each step.

#### WHAT IS VP TO ME? A PERSONAL NOTE FROM AN INDUSTRY LEADER

"VP is the hope and vision that the combination of financial resources, skills and entrepreneurship can give better solutions to manage social needs and become a model to be replicated in the public and the private sectors. Oltre, the social venture capital organisation I founded, has exactly these objectives, and it is particularly conscious that the social environment is more complex than the business one."

**Luciano Balbo**  
Italy

<sup>15</sup> Incremental investments to the same investee.

<sup>16</sup> One Foundation has commissioned independent feedback from their grantees through a quantitative survey, carried out by Centre for Effective Philanthropy in Boston. This gave a clear view of grantee perceptions regarding impact, satisfaction, relationships etc. The conclusion, which is inherent to the VP approach, was that One Foundations had high demands in hours spent by grantees to fulfil funder requirements, but it was worth it.

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## PART 3: THE INVESTMENT PROCESS

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### THE ENTIRE APPRAISAL IS A TWO-WAY PROCESS. DUE DILIGENCE CAN BE USED AS A TOOL TO BUILD A CLOSE RELATIONSHIP.

In many appraisal processes, there will be a need to develop and review a business plan for the target SPO. This can happen at different points in time, depending on the size and capabilities of the SPO. Larger, more established SPOs should be able to write their own plan. This ensures that the applicant maintains ownership of the plan and the objectives it contains. This model requires limited commitment from the investor, with the business plan acting as the starting point for first screening and discussions.

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

The entire appraisal is a two-way process that will require cooperation between VPO and SPO, enabling each to see where and how they can add value (it is a learning process). We encourage transparency of the investor's processes and decision making as many SPOs will not be familiar with practices that the investor may regard as a standard way of working that requires no explanation. Due diligence is the process where an organisation or company's strengths and weaknesses are assessed in detail by a potential investor with a view to investment. It is a tool that can be used to build a close relationship between the two parties (culture and personality fit, mutual trust):

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

#### 3.2.1 First screening

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

- Step 1: Desktop screening of strategic fit between investor and investee
  - Thematic focus
  - Geography
  - Investment size
  - Social relevance/impact
- Step 2: Discussions with management to get acquainted and to get an overall view of the organisation and its activities, projects, partners, etc.

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

### 3.2.2 Detailed screening

Detailed screening, sometimes referred to as due diligence, will usually be performed (at least in part) through analysis and validation of a business plan. Additionally, interviews with SPO management, staff and Board, review of relevant documentation and focussed research on external information sources will be of crucial importance. The detailed screening process will cover at least the following items:

- **Organisation** - legal structure; quality of management; governance; transparency of results, Board quality
- **Market** - Market size, growth, developments, segments; relevant other initiatives / competitive positioning;
- **Sources of income** - Funding trends and funding mix
- **Strategy** - What is the theory of change? This can be built using a decision-making framework, such as the Social Change Model, which links strategic choices back to specific social impacts
- **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.
- **Financial** - History (results, previous financings); budgets and forecasts; funding gap / financial ask; co-financing; terms of investment, financial reporting and control process in place
- **Social** - Track record of execution; social impact targets; monitoring and reporting on social performance

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

- Risks related to the investment
- Potential mitigation measures (conditions for investment)
- Potential phasing of financing (milestones)
- Possibilities for scaling the initiative
- Involvement by VPO fund after investment
- Exit option(s) (see section 3.6)

The time required by the SPO for detailed screening should be in direct proportion to the size of the potential investment. However, in practice, even small investments require substantial screening. VPOs should consider the minimum size of investment required to ensure that their own efficiency is not compromised. If and when a positive decision on the investment is made, understandings and agreements should be laid down in an investment contract between the VPO and the SPO. Before this is finalized, legal due diligence may be performed to eliminate, where possible, the risk of any further obstacles or surprises.

## PART 3: THE INVESTMENT PROCESS

**WHAT IS VP TO ME?  
A PERSONAL NOTE FROM AN  
INDUSTRY LEADER**

“Venture Philanthropy is an engaged, entrepreneurial approach to addressing social issues that aims to maximise long term social impact. In addition to grant-making, it uses a full range of funding instruments, analogous to the commercial venturing sector. Its engagement goes beyond the funding itself. Venture Philanthropists invest their knowledge, vision and financial resources in a context where the necessary commercial investment and government support are lacking. At shærpa we believe that the combination of the business approach of venture philanthropy with the dedication and passion that exists in the social sector will maximize social impact.”

**Pieter Oostlander**  
The Netherlands

**3.2.3 Level of involvement of the VPO in the appraisal process**

Being involved in the appraisal process creates commitment and a motivation for a positive outcome. The VPO should only engage in areas where it can add value and not seek to compensate for the target SPO's lack of resources. Notwithstanding this, outsourcing due diligence or business planning to a third party, or compensating the SPO for undertaking the task itself, creates a more arm's length relationship and can make rejection decisions further down the line easier and more objective. Regardless of the level of involvement agreed, it will be important to spend time with the SPO's entire management team and board, to judge their quality and general 'buy-in' to the plan.

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

**3.3 PORTFOLIO MANAGEMENT**

Portfolio management operates on two levels: at the level of each investee SPO, and at the level of the portfolio as a whole.

**3.3.1 Portfolio management at the SPO level**

The plan for the investment phase engagement should be discussed and agreed with the SPO during the investment appraisal process to ensure there are no surprises. The key elements of investment phase strategy should include:

- Agreed social outcomes / targets
- The nature of the relationship (ideally based on openness, partnership and trust)
- Rights and obligations of both parties
- Frequency of meetings (generally monthly)
- Right of the VPO to appoint a board member or not (see below)
- Key areas for capacity building or adding value (see section 3.4)
- Funding plan (including co-investment) with key milestones
- What happens when things go wrong? (See section 3.3.2)
- Exit planning (see section 3.6)

As mentioned in section 3.2.2, these issues should generally be set out in an investment agreement with the SPO in order to limit future misunderstandings or disappointments.

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

decisions. There are two key questions that will drive the VPO's preferences on board representation:

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

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

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

A 2007 survey<sup>17</sup> suggests that taking board positions is relatively common for VPOs and acts as a key element in supporting an active and engaged relationship with the SPO:

*"By its very nature venture philanthropy requires a degree of partnership and involvement between funder and investee not normally found in social sector funding arrangements. This intimacy is revealed in the typical length of partnership, frequency of contact with management and, rather more controversially, the taking of board places."*

*"When a grant-maker funds a social purpose organisation it would be highly unusual for the funder to take places on the organisation's board. In venture capital, by contrast, this would be normative, indicating ownership through equity and influence at strategic level. 76% of VPOs surveyed may take a formal position on the board of an investee organisation (15% would always take a board place), while 24% would never do so. Even when a VPO did not take a board place 56% would normally attend board meetings as observers or have sight of board papers. In contrast, only 27% of VP organisations in the US (Venture Philanthropy Partners, 2002) would take a board place. This rather more aggressive involvement by European funds is perhaps surprising, but is understandable when considering that the VP organisations in this study are supporting organisations across the SPO spectrum (including social enterprises and businesses with social objectives, where the business model is more open to such involvement). The American organisations reflect more traditional arrangements between grant-makers and non-profit organisations."*

### 3.3.2 What happens when things go wrong?

Building a good relationship with the SPO during the appraisal process is crucial to making a success of the investment phase. The most successful relationships will be

**VP FUNDS CONSIDERING TAKING A BOARD SEAT WILL NEED TO THINK ABOUT HOW THEY WILL HANDLE CONFLICTS OF INTEREST.**

<sup>17</sup> John, R. (2007), "Beyond the Cheque: how venture philanthropists add value," Skoll Centre for Social Entrepreneurship, Said Business School, University of Oxford,. (n = 34; European VPOs surveyed = 32; American = 1; Australian = 1)

## PART 3: THE INVESTMENT PROCESS

## THE MOST SUCCESSFUL RELATIONSHIPS WILL BE BASED ON MUTUAL TRUST AND RESPECT, NOT ON LEGAL DOCUMENTS.

based on mutual trust and respect, not on legal documents and ‘the big stick’. Open engagement with the SPO is the best possible means of obtaining early visibility of problems. This can be maintained in several ways:

- Board representation or observer position (see section 3.3.1)
- Regular (e.g. monthly or quarterly) progress meetings with SPO management and staff
- Regular financial and social performance reporting

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

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

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

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

It is important to recognise that the VPO’s influence depends in part on how much of the SPO’s funding it supplies. It may be able to influence other funders with a similar agenda (e.g., other grant makers – see co-investment, section 2.5.5) but other funders, such as government agencies, may have conflicting objectives.

### 3.3.3 Portfolio management at the VPO level

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



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

- **Flagship investments:** Since VP is an emerging practice, selecting investments in well-recognised and reputable SPOs can be a valuable way to build credibility in the sector and provide leverage for future investment activity. This will be a particularly useful strategy for new funds that are starting to build a track record.
- **Leverage:** It will enhance the mission of the VPO as a whole, as well as the prospects of individual portfolio SPOs, when investments are made in organisations that complement each other rather than compete against each other. This approach creates the possibility to leverage knowledge and experience. These opportunities for cross-SPO leverage should be pursued actively – they should be identified and documented during the investment appraisal process.
- **Competition for resources:** Inevitably, portfolio SPOs will compete for resources – both funding and support - within the VPO. Good account management can help to minimise any problems that arise.
- **Facilitation:** Portfolio managers should be encouraged to create links between portfolio SPOs that have the same client base, for example, or that share the same suppliers. Regular meetings with all portfolio organisations, or a relevant sub-set, will enable experiences to be exchanged.
- **Feedback from SPO:** In addition to routine communication, VPOs with a portfolio of investees can commission independent feedback on the perceived effectiveness of investment model and portfolio management practices e.g. the value to the SPO of investment appraisal processes, reporting processes, and non financial value add. The Euro return on time invested in investment appraisal can also be measured. It is also possible to benchmark these against other VPOs. This has provided valuable lessons to some European funds<sup>18</sup>.
- **VPO's cost efficiency:** It is critically important to track whether the VPO uses its resources efficiently. This is a critically important area to track as VPOs need to report to their funders/investors. As VPOs mature, and need to broaden their investor/funder bases beyond founder and early stage funders, measuring cost efficiency becomes increasingly important. It is valuable for VPOs to start thinking about what to track and how to report on this right from the start of the journey.

### 3.4 ADDING VALUE – CASH PLUS WHAT?

The non-financial element of a VPO's support can be just as important to the investee's development as the cash it provides. Identifying the key areas where the VPO can provide additional value – and deciding how it should be delivered – should be agreed with the SPO during the assessment phase and regularly reviewed.

Advice for providing non-financial support<sup>19</sup>:

- Assess capabilities of SPO and adapt support to capabilities and stage of investment
- Make SPO management team aware that goal is financial and non-financial independence from VPO
- Be aware that relation between team members of VPO and SPO is critical to investment success

WHEN THINGS GO WRONG  
THE FIRST REACTION OF THE  
VP FUND SHOULD BE “HOW  
CAN WE HELP?”

<sup>18</sup> One Foundation has commissioned independent feedback from their grantees through a quantitative survey, carried out by Centre for Effective Philanthropy in Boston.

<sup>19</sup> EVPA workshop on Financing Mechanisms (2010), Brussels June 2010.

## PART 3: THE INVESTMENT PROCESS

### THE FIRST RULE IS 'DO NO HARM'. CAPACITY BUILDING IS NOT ABOUT DOING IT FOR THE SPO BUT HELPING THE ORGANISATION TO DO IT ITSELF.

- Be aware of potential challenges linked to founders' egos and founder syndrome
- Replace CEO when needed

The added value can come from various sources:

- The VPO's management team or board
- Pro bono experts, introduced by the VPO
- Paid consultants, introduced by the VPO
- Paid consultants, introduced by the SPO

Value-adding contributions can have a staff focus – e.g., personal development / coaching / mentoring / training for the chief executive and the team - or an organisational focus – e.g., capacity-building projects in areas such as marketing, income generation or performance management. The table below is taken from a 2007 Skoll survey<sup>20</sup> and sets out the main areas in which VPOs seek to add value to their portfolio organisations:

Non-financial Support	Notes:
Strategy consulting	<i>Incl. business planning</i>
Marketing and communications	
Information technology	
Fund-raising strategy	
Financial management and accounting	
Legal advice	
Human resources management	<i>Incl. recruitment (staff/board), training, appraisal, mentoring</i>
Governance	<i>Strengthening board governance</i>
Change management	
Special advice	<i>E.g. mergers or franchising</i>
Access to networks	<i>Incl. executing fund-raising strategy</i>
Estate management	<i>Building / office relocation advice</i>

There are a number of key observations in relation to added-value interventions:

- The first rule is 'do no harm'. VPOs occupy a position of considerable influence and have a responsibility not to expose an SPO to undue risks or to attempt to impose their own agendas. It must be made clear that any advice offered is just that. The SPO's board and management make the final decisions.
- The SPO needs to be in complete alignment on whatever issue is being addressed - the board, the CEO and the rest of the organisation need to have shared expectations.
- It is important to remember that capacity building is not about doing it **for** the SPO but helping the organisation to do it itself.

<sup>20</sup> John, R. (2007), "Beyond the Cheque: how venture philanthropists add value," Skoll Centre for Social Entrepreneurship, Said Business School, University of Oxford. (n = 34; European VPOs surveyed = 32; American = 1; Australian = 1)



- If using third party service providers, it is important to evaluate not only the specific skills required for the assignment but also the attitude of the individuals involved. Senior people from the business world may have the right expertise but may not be able to translate that expertise into a non-profit setting.
- It is worth obtaining feedback from all participants during and on completion of a particular project. If the project is not working, it is crucial to recognise this quickly and intervene. Obtaining good feedback may be easier if a third party is undertaking the work.
- It can be difficult to obtain pro bono commitments from commercial companies. There may be buy-in at a senior level, but that will not ensure that the over-worked person who is assigned the task has the time or the motivation to complete it on schedule and to the right level of quality. If volunteers are sought, there may be no response or those responding may not have the appropriate skills or seniority. Ideally, pro bono projects should be set up so that those doing the work are motivated to behave as if they were in a paid relationship, so that quality and timescales do not suffer.

**YOU SHOULD ADDRESS PERFORMANCE MEASUREMENT AT BOTH THE INVESTMENT LEVEL AND AT THE FUND LEVEL.**

### 3.5 SOCIAL PERFORMANCE MEASUREMENT

With social objectives at the heart of their business, measuring and managing social impact is an innate function of both social purpose organisations and VPOs. While an area with still many methods and bespoke practices around, there is an increasing recognition of the need for standardisation, but so far only a limited convergence of views or practices about standardising the measurement among funders working with a single SPO or within the same social sector. Considering the benefits the financial markets have enjoyed from common accounting frameworks, such standardisation, although still debated, may be in the best interest of individual VPOs and the social capital sector as a whole.

In VP, each step of the investment process should involve aspects of social impact measurement. A simple recommendation is to define key objectives and targets upfront, decide on specific indicators that could be used to measure results, enable the SPO to do so, then measure results against those indicators.

#### **Example of social performance measurement at a VPO: King Baudouin Foundation<sup>21</sup>**

When King Baudouin Foundation (KBF) has selected an organization to support through the VP methodology, they first take two months to identify two or three indicators with the organization staff. Developing the indicators in partnership with the organization is key to increasing the buy-in of management and the likelihood of turning the indicators into management tools. The indicators are used to set a clear goal and a deadline. To establish these 3 goals, they have several meetings and discussions, and then the three objectives are put in the contract with KBF.

Example of three impact assessment indicators:

1. Have two years to get EFQM label and prepare for the succession of the Director
2. In six months, will implement a new accounting system
3. Have two years to optimize relationship with stakeholders

<sup>21</sup> Metz Cummings, A. and Hehenberger, L. (2010), "Strategies for Foundations: when, why and how to use Venture Philanthropy", EVPA Knowledge Centre Research Paper.

## PART 3: THE INVESTMENT PROCESS

## DEVELOPING THE SOCIAL OBJECTIVES IN CLOSE PARTNERSHIP WITH THE SPO GIVES THE LATTER OWNERSHIP OF THE PROCESS AND ENHANCES THE PROBABILITY THAT THE SPO WILL USE THE SOCIAL OBJECTIVES AS A MANAGEMENT TOOL.

The VPO should clearly communicate its strategy regarding the social objectives it expects its investees to achieve. However, setting targets upfront does not imply prescribing which standards to use. Aligning the needs of the SPO and the VPO with respect to impact measurement is a crucial aspect of establishing a sustainable framework that forms the basis of a long-term partnership. An agreement on the key social objectives and the framework for measuring, monitoring, and evaluation should be one of the results of a successful investment process.

Developing the social objectives in close partnership with the SPO gives the latter ownership of the process and enhances the probability that the SPO will use the social objectives as a management tool. “Working together with the investee to develop an impact measurement system that is useful and understandable to all parties”<sup>22</sup> by EVPA members interviewed in an EVPA KC research study. Therefore, ensuring that the measurement systems are valued and “owned” by the investee may effectively improve the management of the investee by enabling them to learn how to do better and to implement that learning.

### 3.5.1 Selection of a method for measuring social performance

Performance measurement methods range from qualitative approaches to instruments that aim to quantify and relate input to results. In selecting a method for measuring social performance, a VPO should carefully evaluate its objectives for measuring impact. Objectives could include to inform decision-making, enable learning, monitor performance over time or allow consistent reporting to a knowledgeable group of investors.

#### Why use Social Performance Measurement (PM)<sup>23</sup>

Internal:	External:
<ul style="list-style-type: none"> <li>▪ Internal for investor               <ul style="list-style-type: none"> <li>▪ Portfolio-analysis</li> </ul> </li> <li>▪ Internal for investee               <ul style="list-style-type: none"> <li>▪ Management tool</li> <li>▪ Marketing</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ Reporting</li> <li>▪ Marketing and PR</li> <li>▪ Control / external audit</li> <li>▪ Accounting               <ul style="list-style-type: none"> <li>▪ Financial accounting</li> <li>▪ Social accounting</li> </ul> </li> </ul>

We propose the following three concrete steps that you could use to set up a framework for measuring social performance:

- **Step 1: Issues and objectives:** Ask the SPO the following fundamental questions related to its social mission, which will form the basis of the social performance measurement system:
  - What are the social issues that you target?
  - What are the magnitude and urgency of each issue?

<sup>22</sup> Maretich, M. and Bolton, M. (2010), “Social Enterprise: From definitions to developments in practice”, EVPA Knowledge Centre Research Paper.

<sup>23</sup> EVPA workshop on Performance Measurement (2008), Barcelona, June 2008

- What can you do to resolve the issue and what are your competitive advantages to be successful?
- How can your actions be linked to solving the issue, taking into account the effects of other players' actions?
- **Step 2: Impact value chain:** Analyse how the SPO achieves the change described in step 1. This analysis may require several weeks of close collaboration between the VPO and the SPO management. Key considerations include:
  - Identify the stakeholders that are affected by the activities of the SPO;
  - Identify input activities contributed by the stakeholders and define the expected outputs;
  - Determine outcomes that create significant value to the stakeholders
  - Value the size of the outcomes in order to determine the key value drivers;
  - Establish key performance indicators (KPIs) to measure change;
  - Assess which part of potential change is caused as a result of the activities of the SPO;
- **Step 3: Monitoring and evaluation:** Measure the results of SPO activity against key social objectives determined in step 2. Monitoring and evaluation is usually relatively continuous, with regular meetings and reporting requirements set up between VPO and SPO. The VPO should consider implementing the following:
  - Set up systematic monitoring to assess to what extent the expected changes are achieved;
  - Establish a governance structure that promotes evaluation of the social objectives, and involves the key stakeholders;

THERE SHOULD BE AN OPEN DISCUSSION ON AND A COMMON UNDERSTANDING OF THE EXIT. THIS CAN BE FIXED AT A DEFINED POINT IN TIME OR WHEN CERTAIN CONDITIONS ARE MET.

#### **What EVPA members are doing about social performance measurement - evidence from EVPA KC research paper<sup>24</sup>:**

Most of the [VP] funds ... expected the projects they funded to establish impact measures of one kind or another. The way the funds did this varied widely. Frequently, different methods were used with different organisations in a given portfolio. "One of the shortcomings is that we have to operate on a case-by-case basis, there's no cohesion," said one fund manager. Criteria for impact and performance were typically established during the process of due diligence, according to interviewees. Some funds, especially those like Voxtra who look for organisations who already have a sound business model in place, look for a good measurement regime as an indicator of fitness for investment. Others, like Impetus and UnLtd, who typically work with organisations at an earlier stage in their development, will help establish measures as part of their non-financial development work.

One interesting move in the area of social performance measurement is the collaboration between three EVPA members - dob Foundation, Noaber Foundation and Peter Scholten - to develop a Social e-Valuator, setting up a social enterprise with the same name. Their methodology is based on Social Return on Investment (SROI). EVPA members have expressed a desire to achieve standardisation in the field of social performance measurement, although the challenges involved are also acknowledged.

<sup>24</sup> Maretich, M. and Bolton, M. (2010), "Social Enterprise: From definitions to developments in practice", EVPA Knowledge Centre Research Paper.

## PART 3: THE INVESTMENT PROCESS

## KEY ISSUES AND LEARNINGS

- **Deal flow - Getting the right volume and quality of deal flow is critical.** To enable this, most funds take a proactive approach to identifying and engaging with target SPOs, rather than establishing an open application process.
- **Investment appraisal - While the precise process varies from organisation to organisation,** most employ multiple screens. Final investments are usually made on the basis of the SPO's business plan.
- **Investment phase - During investment phase, the VPO will be actively engaged with investee SPOs** on an ongoing basis. This engagement can take many forms but it should be agreed during the investment appraisal process.
- **If things go wrong - If an investment does not go to plan, the VPO should be ready to step in and help the SPO to solve problems.** Non-financial support may be just as important as - and sometimes preferable - to additional funding.

Continued opposite

The VPO should consider whether it creates an additional reporting burden for the SPO by requiring it to write different performance measurement reports for separate investors, when a single performance measurement framework might be sufficient. Agreeing on a single performance measurement framework can greatly help to reduce duplication of effort, leading to efficiency gains for both SPO and investors. However, there is still little convergence between funders on metrics and SPOs carry a heavy reporting burden as a result. A good guiding principle is that the performance measurement should act as a management tool for the SPO when making tactical decisions, and provide strategic information to its board and funders.

### 3.5.2 Evaluating performance at the VPO level

Social performance measurement at VPO level involves trying to measure the social impact of the entire portfolio of investments. In theory, the overall performance of the VPO can be assessed by adding together the social impact of its various investee companies. In practice, however, aggregation across a VPO's portfolio of investees is a complex process. After all, how does one compare the social impact of providing primary school education to a number of schoolchildren in Tanzania with cleaning a river system in France? Aggregation is easier to undertake when the VPO has a narrow sector focus with comparable investee SPOs. VPOs with multiple objectives can choose to define homogenous clusters of investees, and aggregate social impact within these clusters. For example, investees that are scaling children's services through different models, or targeting different age groups or different geographies could cluster performance metrics on improved outcomes for children, numbers of children reached, cost per child, etc. Still, this also requires establishing a fairly common set of outcomes and indicators on a generic theory of change.

While a VP should have aggregation of data in mind when selecting a measurement method, an SPO should make sure that it can use the measurement process to manage its business. A method like Balanced Scorecard performs quite well in informing business strategy, but is much harder to aggregate on a higher level. Some quantitative methods can capture and aggregate input and outputs. Combining impacts into a generic unit (e.g. number of people reached) can be problematic because one type of initiative that deals with large populations (such as microfinance) will completely outweigh other smaller, although important and high-impact initiatives. A high output (e.g. lives touched) does not necessarily imply significant value. Methods like SROI attempt to capture value, but aggregating outcomes is still difficult given the lack of uniform measures. Without promoting a particular method, the sector would benefit from VPOs connecting with existing methodologies rather than developing bespoke concepts. Initiatives like Social e-valuator, IRIS/Pulse, the SROI Network, Imp-Act, and GIIRS all promote common standards, which are often complementary, rather than competing. EVPA is developing guidelines to recommend the use of social performance measurement and to move towards standardisation in this area.

### 3.6 EXIT

In most cases, an SPO's funding horizon will be longer than a VPO's investment horizon. Hence there will be a point in time where the relationship between SPO and VPO will end. This separation is called 'exit'. Some of the pioneer VPOs such as Impetus Trust, One

Foundation and Noaber Foundation have already experienced their first exits. In all cases, an abrupt exit by a major funder can have a profound impact on future sustainability of the SPO or its future adherence to its mission. The exit process, therefore, needs to be clearly defined and understood, and managed carefully. The approach to exit will vary based on the funding instrument used (grant versus other funding instrument) and the SPO's position on the spectrum (see section 1.3; ranging from SPO's that depend completely on grant funding to SPO's that are partially financially self-sustaining). Some core principles are proposed below on exit planning, and some practical approaches are suggested for grant-funded investments and for social investments.

Exit creates challenges for both successful and unsuccessful SPOs. Indeed, SPOs that have achieved high levels of social impact, and who have grown accordingly, but are grant funded, may be even more exposed than those that have failed to develop successfully. For organisations like these, it is difficult to generate a truly objective measure of financial sustainability. These factors will affect any decisions that a VPO might take in relation to exit. The following principles are recommended in relation to exit planning:

- Developing a view on the most appropriate exit strategy will require the VPO to address its own social and financial objectives and the metrics it employs to measure success (see section 3.5). In any given situation, the exit strategy – defining when and how you will step out - should address the possibility of success or failure.
- Discuss exit before any investment has been made. Unless the VPO plans to support the SPO indefinitely (which is not really in keeping with the principles of VP), there should be an open discussion on and a common understanding of the exit. This can be fixed at a defined point in time or when certain conditions are met.
- It is advisable to start preparing the SPO for exit several years before time of expected exit, to strongly involve CEO, senior hires, management and board in exit preparations, and help develop their leadership skills.
- The VPO should align the timing of the exit with the initial investment time horizon, usually defined from the very start in accordance with the VPO's investment goals. However, the exit timing should not be set too rigidly, since the prevailing situation in the SPO will affect the exit decision. Ideally, funding should taper off towards the end of the anticipated investment period.

### 3.6.1 Planning exit for grant funded investments:

When planning the exit from a grant-funded investments, one must take a slightly different approach towards financial sustainability than for social investment. Indeed, the SPO may not be in a position to generate its own income and may still be dependent on external fund-raising. Therefore, the VPO must consider both the “**organisational resilience**” and the “**financial resilience**” of the SPO when assessing its exit readiness:

- Financial resilience will include -
  - A wide range of income sources (earned income is generally the highest quality income stream)
  - A balance sheet with a sufficient buffer (reserves)

- **Cash plus what ? - Providing non-financial support, in addition to hard cash, is one of the cornerstones of VP.** The VPO should set and agree the parameters of such support with the SPO, so that it is seen as valuable by both sides and addresses real needs.
- **Measuring performance - Evaluating the impact of an investment is another distinctive element of VP investing.** Assessing performance in relation to social objectives is notoriously difficult. The problem is compounded when seeking to assess performance of the overall portfolio as well. Despite these challenges, some methodologies do exist, although most require a significant level of tailoring.
- **Exit strategies will be largely defined by the financial instrument used to invest:** grant or social investment.

- Organisational resilience will include:
  - Strength of the management team and its readiness for the next phase
  - Board skills and quality
  - Strength of brand and profile
  - Fund-raising capability.

Remember that meeting the above tests for exit will drive decisions such as CEO selection and Board member appointment (fund-raising capability becomes critical to both), and may drive decisions on investment conditions such as where the VPO plans to add value. The following recommendations further apply to planning the exit for grant-funded investments:

- Investigate income generation possibilities during investment process and include as a standard component of capacity building
- When necessary, exit should be accompanied by an effort on the part of the VPO to find alternative investors or donors.
- Be aware that, in general, an unsuccessful investment may be easier to exit than a successful one, in which strong incremental value has been created or where there is an obvious need to fund further growth.
- Finally, you may wish to consider an exit in tandem the potential entry of public sector partners. VP serves to act as a platform for scale-up and innovation. In some European countries the public sector can play a critical role in building further scale, to national or international level. For certain investments, therefore, VPOs should consider engaging with the public sector in order to identify opportunities to bring together exit and entry timeframes. Building and maintaining relationships with the public sector may be challenging due to different working styles, priorities, language or timeframes. Furthermore, the financial crisis has affected the funding available to the public sector. However, some VPOs believe that investigating opportunities for exit to the public sector should be pursued actively.

### **3.6.2 Planning exit for Social Investments**

The exit planning and process takes a different form when social investment is used. The exit-planning at the start of the investment may influence the choice of funding instrument. Bridging a temporary shortfall in cash in the SPO, may be funded with a loan or similar instrument when related risks are low. This will predefine the exit moment in a more natural way. In any case, flexibility needs to be applied when defining the actual moment of exit. Achieving predefined goals usually takes more time than initially planned, Also, when goals are met, it may take additional time to find and organize a proper exit. The VPO should build in the possibility of stretching its involvement and support beyond pre-defined time limits in order to facilitate an exit and to prevent adverse impact on the SPO's performance.



In general the exit from an SPO that was funded by social investment may become apparent when:

- The step-change that was intended with the investment is achieved
- The SPO has reached a situation where it is self-funding
- The SPO's development or growth requires other qualities of non-financial support or other scale of funding than can be supplied by the VPO.
- It becomes clear that the intended social change that the SPO and VPO Fund targeted cannot be achieved

The type of exit will in most cases be defined by the type of funding instrument that was applied, except in case of equity or the like type of funding. When funding is through guarantee, loan or similar type of funding, the SPO and VPO have to decide whether the involvement of the VPO terminates at the expiry or repayment date (or actual repayment) or if it extends beyond that point, and if so, when the engagement and non-financial support will come to an end.

If the VPO holds an equity stake in the SPO, either through a straight equity funding, or through the conversion of a convertible grant or loan, special attention is required with respect to the exit moment and the exit type. For a proper timing of the exit, the VPO will have to continuously monitor its relationship with the SPO and assess the added value it brings to the social goal. Added value below a certain point should trigger the exit process.

The exit in case of an equity stake is complex and compares to a large extent to that of grant funded investments. The main issue to be addressed in this case however is most likely not the financial resilience or sustainability, but the possibility for the social mission of the SPO to survive the exit. Exit of an equity stake can be achieved by:

- Sale of the stake to another VPO or social investor,
- Buy-back, or hand-over of equity stake to the SPO itself,
- Sale or hand-over of equity stake to stakeholders related to the social issue being addressed by the SPO.
- Strategic sale or merger of the SPO.
- Sale of equity to a regular Venture Capital investor.

The final two possibilities require special attention for the protection of the SPO's mission. This mission should be anchored in the SPOs articles of association and legal entity form where possible. The VPO exiting the investment will have to select the buyer of its stake to be the one that best endorses and enhances the mission of the SPO going forward. Failure to protect the social mission of the SPO is equivalent to a failed exit, and in the end a negative social return on the VPO's investment. Furthermore, VPOs should not regard as a successful exit strategy their replacement by another "social" funder, if they have not worked with the investee towards some form of longer term sustainability. VPOs should exit at the point where they feel they cannot add more to the development of the SPO.

#### **WHAT IS VP TO ME? A PERSONAL NOTE FROM AN INDUSTRY LEADER**

"VP is all about relating to grants the way a professional, long-term owner relates to investments; conduct rigorous due diligence, measure and monitor performance, hold people accountable, and make a healthy exit – all to maximize your social return on investment."

**Pål Dale**  
Norway

PART 4

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# REFLECTIONS ON THE JOURNEY SO FAR



Venture Philanthropy is a relatively new addition to the philanthropy toolkit. In Europe the industry is less than ten years old. Although it is important to recognise the roots of VP in the learning which has come from the US market over the last ten years, we have now reached a point where we have developed our own practice, which is taking on a distinctively European character. European VPO's have been able to "bend" USA models to match their own political and cultural contexts, ranging from Western European welfare states to emerging markets in Central and Eastern Europe.

In our first edition in 2008, we documented how VP itself was an innovation emerging from both the philanthropic and investment worlds/markets, and the founding players in Europe were innovating through applying investment principles to investments in order to support them to make a step change in their impact. The nature of the innovation was the development and testing of VP tools and approaches in different political economic and cultural contexts across Europe and also in the developing world.

#### ***Where is the innovation in VP now?***

A new market in social investment, targeting social enterprises, is emerging, which is developing rapidly, driven by the need to accelerate provision of high quality and cost effective social services, in an environment where privatisation of social provision (including to the social sector) is growing rapidly. This development has been fuelled by the recent financial crisis and the shrinking of public funding available. Examples include health services, childcare, education, employment-readiness and housing. Investment in social enterprises with revenue streams has driven the need to broaden the financial instruments used, creating a social investment movement which complements and builds on the use of grants in the initial VP movement. As the VP industry matures, we expect further sophistication in terms of financing mechanisms used by social investors. In this new edition, we have highlighted where different methodologies are required as a consequence of using a social investment or a grant funding strategy.

But grants as financial instruments have not gone out of fashion. Many of the founding players, as well as new entrants, continue to use grants as all or part of their financial toolkit. These players have continued to innovate through building experience of second and third round investments, and of exit. We see these experiences reflected in this new edition.

#### ***What has the maturing of the VP industry meant over the last two years?***

We have seen a greater confidence in the use of the tools and approaches of VP, as well as greater recognition of the value that the VP toolkit can add to the wider philanthropy market in Europe. We are getting closer to scale with EVPA members now in over 20 countries across Europe. The greater diversity of the players adds to the breadth of experience that can now be shared within the industry. A sister network, Asia Venture Philanthropy Network<sup>25</sup>, has been set up in Asia by one of the founders of EVPA.

Venture philanthropy has found investors and developed co-investment relationships with a whole range of players in recent years – broadening our partners substantially as we have gained credibility and established a track record. Trusts and foundations, corporations, governments, and of course individual philanthropists have all found value in VP approaches. New entrants to the VP market since the last edition include Inspiring Scotland, a VP fund co-invested by Lloyds TSB Foundation and the Scottish government, Fondazione CRT, a foundation that originated from Cassa di Risparmio di Torino in 1991

<sup>25</sup> Asian Venture Philanthropy Network (2010), <http://avpn.asia/index.htm> (Accessed October 2010)

#### PART 4: REFLECTIONS ON THE JOURNEY SO FAR

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following the saving bank's privatization in Italy, and BMW Foundation in Germany, one of several corporate foundations that are moving into the VP space.

The European VP market continues to show a passion for experimentation, in applying its model to a diverse range of SPO's, from social service providing organizations to pure advocacy to organizations focused on system change in their sector e.g. public health services. We have not been short on trying and testing and have experienced and learned from failures as well as successes. We encourage more VPO's to share their experiences of both in the spirit of learning.

European venture philanthropy has yet to reach scale and demonstrate its ability to achieve systemic change. However, since 2008, there are more VPO's in more countries with more funds under management, and we have more deals under our belts. The industry has begun a process of diversification - by sector, geography and growth stage of the SPO, as well as by general approach. It has also matured. In this new edition, we have documented the experience of the founding players in Europe, some of whom have now completed second and even third round investments, and have deeper experience of exiting deals. The practices of VP have been refined through experience. We are getting closer to holding data on the impact of European VP.

In terms of VP's overall impact on the philanthropic sector, VP has made an important contribution to the debate on philanthropy's role and methods, especially on key issues such as:

- The active role of social investors and the nature of the partnership relationship with the SPOs they invest in
- The importance of helping to grow the capacity and skill-sets of SPOs (in addition to financial support)
- The use of different financial instruments, depending on the specific needs and circumstances of target SPOs
- The importance of measuring social performance of both investees and funders
- The added value of active participation and board level input
- The search for other, financially sustainable operating models for SPOs, helping them to be more resilient.

All of these issues are important to the broader world of philanthropy, and the emergence of VP has helped to sharpen the debate.

EVPA members have ambitions that range from making a step change in impact in a single SPO in their own market, to creating and / or transforming the capital market for social sector deals in Europe. While some of these aspirations may seem grandiose, we wouldn't bet against them.

We look forward to the next stage of innovation and learning in venture philanthropy and social investment, to learning and sharing that learning, and to contributing to the emerging global debates on impact and methodology in North America and Asia. But we remind ourselves of why we do this, to improve the world we live together.



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# GLOSSARY OF TERMS

### Balanced Scorecard

The Balanced Scorecard was developed by Professor Robert Kaplan (Harvard Business School) and Dr David Norton in 1992 as a 'performance management framework that added strategic non-financial performance measures to traditional financial metrics to give managers and executives a more "balanced" view of organisational performance... [it] transforms an organisation's strategic plan from an attractive but passive document into the "marching orders" for the organisation on a daily basis, helping people to identify what should be done and measured.

Source: [www.balancedscorecard.org](http://www.balancedscorecard.org)

*New Profit Inc, based in Boston, MA, in partnership with Professor Kaplan has adapted the Scorecard for the non-profit sector adding the 'social impact' perspective.*

See also: [www.newprofit.com](http://www.newprofit.com)

### Below market return

Level of return on investment which is lower than the average level of return offered by the financial market, for an investment with the same risk profile.

### Blended Value

As defined by Jed Emerson, who coined the term, 'the Blended Value Proposition states that all organisations, whether for-profit or not, create value that consists of economic, social and environmental value components – all that investors (whether market-rate charitable or some mix of the two) simultaneously generate all three forms of value through providing capital to organisations. The outcome of all this activity is value creation and that value is itself non-divisible and, therefore, a blend of these elements'.

Source: <http://blendedvalue.org>

### Business plan

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

### Capacity-building / Organizational development

Approach aimed at strengthening organisations supported to increase their overall performance by developing skills or improving structures and processes.

### Co-investment (also known as Co-funding)

In private equity, co-investment is the syndication of a financing round or investment by other funders alongside a private equity fund. In venture philanthropy, it involves the syndication of an investment into a social purpose organisation (SPO), by other funders (e.g. grant-makers or individuals) alongside a venture philanthropy organisation.

### Core costs

Recurring expenses generated by the operation of an organisation which are not directly related to the level of activity, by opposition to project or programme costs.

### Deal flow

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

### Debt financing (also see Loan)

Debt financing is borrowed money used to finance a business, either traditional or social enterprise. Usually, debt is divided into two categories: short-term debt for funding day-to-day operations, and long-term debt to finance the assets of the business. The repayment of short-term loans usually takes place in less

than one year. Long-term debt is repaid over a longer period.

### Due diligence

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

### Equity financing (see also Quasi-equity)

Funding provided by an investor to an organisation that confers ownership rights on the investor. These rights allow the investor to share in the profits of the organisation, usually in the form of dividends. Equity investors are diverse, including the organisation's founders, friends, family, institutions and angel investors. Venture philanthropy funds may provide a source of equity financing for social enterprises.

Newer, and still experimental, means of ownership (e.g. a Community Interest Company in the UK) allow equity purchase but place a cap on the financial return.

### Exit

The end of the relationship between the venture philanthropy investor and social purpose organisation (SPO). The nature of the exit will normally be agreed before the investment is completed. In the case of a charity, the venture philanthropy funder will ideally be replaced by a mix of other funders (see financial sustainability). The time scale for the exit can be agreed upon at the outset. In the case of a social enterprise, exit may require the repayment of a loan, for example, and the timing will depend on the commercial success of the enterprise.

### Financial sustainability

Financial sustainability for a social enterprise is the degree to which it collects sufficient revenues from the sale of its services to cover the full costs

## GLOSSARY OF TERMS

of its activities. For charities, it involves achieving adequate and reliable financial resources, normally through a mix of income types.

### Foundation

Public-benefit foundations are asset-based and purpose-driven. They have no members or shareholders and are separately constituted non-profit bodies. Foundations focus on areas ranging from the environment, social services, health and education, to science, research, arts and culture. They each have an established and reliable income source, which allows them to plan and carry out work over a longer term than many other institutions such as governments and companies. In the context of VP, foundations are non-profit organisations that supports charitable activities either through grant-making or by operating programmes.

Source: <http://www.efc.be/NewsKnowledge/Pages/FoundationsInTheEU/Whatisafoundation.aspx>

### Fund

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

### Grant financing

Non-returnable money, property, services or anything else of value that is transferred to an organisation without conferring any form of ownership rights on the donor.

Note that some VPOs and grant-makers do use "returnable grants" from time to time. This may involve the return of all or part of a grant, contingent upon an agreed event. For example, a grant might be given to enable fund-raising but if the fund-raising is successful or exceeds agreed levels, a portion of the grant may be returned.

### Grant-maker

Grant-makers include institutions, public charities, private foundations, and giving circles, which award monetary aid or subsidies to organisations or individuals. Generally known as foundations in Continental Europe, grant makers also include certain types of trusts in the United Kingdom.

### High-engagement funding

High-engagement funding, as defined in a seminal article by Letts and Ryan, 'is first and foremost a performance-centred strategy where alignment, reliable money and strategic coaching are used together to convert a grant financing relationship into an accountability relationship that uses power to improve performance. High-engagement funders believe that improving the performance of non-profit organisations is the best means of achieving their social goals'. High-engagement funding has many of the features of venture philanthropy.

Source: Letts, C. W. & Ryan, W.P. (2003) "Filling the performance gap. High-Engagement Philanthropy. What Grantees Say About Power, Performance, and Money", Stanford Social Innovation Review

### Impact investing

Impact investing is a form of investment that aims at generating social impact as well as financial return.

### In-house Resources

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

### Investee

The social purpose organisation that is the target of VPO activity and the

recipient of financial and non-financial support.

### Investment

An investment is the use of money with the expectation of making favourable future returns. Returns could be financial, social, and/or environmental (See entry: Triple-bottom-line)

### Investment phase

The investment phase is the period between the investment of monies into the project, organisation, or social entrepreneur, and the exit.

### Investment proposal

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

### Key performance indicators

Key performance indicators are financial and non-financial, quantifiable metrics used to measure the progress against the objectives of the project, organisation, or company.

### Loan (see also Debt)

A loan is a sum of money lent at interest, where financial return is sought. (It is common for venture philanthropy organisations (VPOs) to provide loans at reduced interest rates or have other 'softer' features, i.e. on repayment terms.)

### Long-term investment

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

### Mezzanine financing

Mezzanine financing is a hybrid of debt and equity financing, usually used to fund the expansion stage or an organisation. Although it is similar to debt capital, it is normally treated like equity on the organisation's balance sheet.



### **Non-financial services (value-added services)**

In addition to financial support, venture philanthropists provide value-added services such as strategic planning, marketing and communications, executive coaching, human resources advice and access to other networks and potential funders. Non-financial support is offered by volunteers, VP staff, donors or third party consultants.

### **Outcomes**

Outcomes are the ultimate changes to people's lives that the social purpose organisation is trying to achieve, resulting in changes to the social system, or impact. This might include changes in attitude, behaviours, knowledge, skills, or status.

### **Outputs**

Outputs are results that a company, non-profit, or project manager can directly assess or measure.

### **Portfolio**

A portfolio is a collection of projects and/or organisations that have received sponsorship from the investor. A distinction is often made between 'active' and 'past' portfolio, to distinguish between the organisations with which the investor is actively involved. Usually, however, all portfolio organisations are included in the greater network of the investor.

### **Portfolio (or investment) manager**

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

### **Pre-investment stage**

The pre-investment stage is the process during which the investor examines the operations and leadership of the project or organisation with a view towards making an investment. This

might include a detailed review of the financials, operations, or reference checks for organisational leaders. The term due diligence is also used, which has a legal definition as a measure of prudence. In other words, the investor is assessing if it is likely to get what it thinks it is paying for.

### **Private Equity**

Ownership in a firm which is not publicly traded and which usually involves a hands-on approach and a long-term commitment for the investors.

### **Quasi-equity**

Quasi-equity is a financial instrument that aims to reflect some of the characteristics of shares (preference or ordinary). However, it is neither debt nor equity, and is usually structured as an investment whereby repayment is linked to the investee's financial performance (e.g. repayment is calculated as a percentage of the investee's future revenue streams).

*Source: Venturesome (Paul Cheng)*

### **Return on Investment (ROI) (see also Social Return on Investment (SROI))**

The Return on Investment (ROI) is the profit or loss resulting from an investment. This is usually expressed as an annual percentage return.

### **Scaling up**

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

### **Seed financing**

Seed financing is money used for the initial investment in a start-up company, project, proof-of-concept, or initial product development.

### **Short-term Investment**

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

### **Social (and ecological) sector**

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

### **Social capital market or social investment market**

Financial market dedicated to social investment which aims at systematizing and facilitating social capital allocation.

### **Social enterprise**

Social enterprise is an organisation that focuses on achieving social impact, applying market-based solutions to address public sector and market failure in innovative ways. Social enterprise can take on a variety of legal forms.

*Source: EVPA definition presented in Maretich, M and Bolton, M (2010). Social enterprise: From definitions to developments in practice. EVPA*

### **Social entrepreneur**

Social entrepreneur is defined by the Schwab Foundation as 'a different kind of social leaders who: Identifies and applies practical solutions to social problems by combining innovation, resourcefulness and opportunity [and] Innovates by finding a new product, a new service, or a new approach to a social problem'.

*Source: www.schwabfound.org*

### **Social finance (or investment)**

Social finance 'may be understood as a broad area wherein various forms of capital are structured in ways that consider and value both financial performance and social value creation'.

*Source: Emerson, K. Freundlich, T. and Fruchterman, J. (2007), "Nothing Ventured, Nothing Gained: addressing the critical gaps in risk taking capital for social enterprise" Skoll Centre for Social Entrepreneurship, Said Business School, University of Oxford.*

## GLOSSARY OF TERMS

### Social impact

The social benefit derived from the activities of a social purpose organisation (SPO) or venture philanthropy organisation (VPO).

### Social indicators (see Social Impact, SROI, Balanced Scorecard)

Key performance indicators specifically adapted to measuring the performance of social purpose organisations.

### Social investing

Investing, in social purpose organizations, that may generate a financial return, but whose primary purpose is to generate social impact

### Social Purpose Organisation (SPO)

The term SPO captures the entire spectrum of organisations whose primary purpose is to create social value (rather than shareholder value). The terminology for these different kinds of organisation varies enormously across countries and jurisdictions, and is therefore far from precise. The following types of organisation will fall under the banner of SPOs:

- Charity, non-profit, not for profit, foundation, association, company limited by guarantee, (having no trading activities, or where trading is of marginal importance)
- Social enterprise, Community Interest Company, (having trading as a significant or exclusive part of their operations). Some do not make any financial returns to investors (or cap returns) but reinvest surpluses into the organisation. Even within social enterprise there are several different models.
- Socially driven business – profit distributing businesses but with clear and stated social objectives.

### Social Return on Investment (SROI)

The Social Return on Investment (SROI) analysis was developed by REDF in 1996

in the US, a non-profit enterprise that makes grants to a portfolio of non-profit agencies. SROI places a dollar value on ventures in the portfolio with social as well as market objectives, combining tools for benefit-cost analysis (used by economists) and tools of financial analysis. SROI has also been used by other organisations in a modified form. Within EVPA, the social e-valuator and the SROI network focus on the SROI tool.

### Social venture capital

Social venture capital is an enterprise approach to tackling social problems through investment to support the creation and expansion of commercially sustainable enterprises to maximise social and financial returns. In developing countries, this approach is used to create jobs and empower the poor.

### Syndication

Temporary association of funders who jointly invest in a specific project or organisation.

### Triple-bottom-line investment (see also Blended Value)

Triple-bottom-line investment is the simultaneous pursuit of beneficial returns along three dimensions: economic, social, and environmental.

### Venture philanthropist

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

### Venture philanthropy

Venture philanthropy works to build stronger social organisations by providing them with both financial and non-financial support in order to increase their social impact. The organisations supported may be charities, social enterprises or socially driven commercial businesses, with the precise organisational form subject

to country-specific legal and cultural norms.

As venture philanthropy spreads globally, specific practices may be adapted to local conditions, yet it maintains a set of widely accepted, key characteristics. These are:

- **High engagement:** venture philanthropists have a close hands-on relationship with the social purpose organisation they support, driving innovative and scalable models of social change. Some may take board seats at these organisations, and all are more intimately involved at strategic and operational levels than in many other forms of philanthropy, significantly reducing the number of organisations supported to around 10-15 for the average VP organisation.
- **Tailored financing:** as in venture capital, venture philanthropists take an investment approach to determine the most appropriate financing for each organisation. Depending on their own missions and the ventures they choose to support, venture philanthropists can operate across the spectrum of investment returns. Some offer non-returnable grants (and thus accept a purely social return), while others use loan, mezzanine or quasi-equity finance (thus blending risk-adjusted financial and social returns).
- **Multi-year support:** venture philanthropists provide substantial and sustained financial support to a limited number of organisations. Support typically lasts three to five years, although timescales may become longer as VP in Europe develops. The VPO's objectives will include helping the organisation to become financially self-sustaining by the end of the funding period.

- **Non-financial support:** in addition to financial support, venture philanthropists provide value-added services such as strategic planning, marketing and communications, executive coaching, human resource advice and access to other networks and potential funders.
- **Organisational capacity-building:** venture philanthropists focus on building the operational capacity and long-term viability of the organisations in their portfolios, rather than funding individual projects or programmes. They recognize the importance of funding core operating costs to help these organisations achieve greater social impact and operational efficiency.
- **Performance measurement:** venture philanthropy investment is performance-based, placing emphasis on good business planning, measurable outcomes, achievement of milestones, and high levels of financial accountability and management competence.

#### **Venture Philanthropy Organisation (VPO)**

A venture philanthropy organisation provides long-term financing to social purpose organisations (SPOs) operating with the principles of venture philanthropy.



EVPA is a fast-growing membership association supporting and promoting venture philanthropy across Europe. EVPA supports its members by providing a forum for mutual learning, data and research on venture philanthropy, and training programmes on topics relevant to all stages and activities of a venture fund.

The EVPA Knowledge Centre is the hub for European knowledge and thought leadership on venture philanthropy. Its mission is to:

1. Provide EVPA members with resources and knowledge to assist them in the development of strategy and best practice .
2. Provide EVPA / VP field with legitimacy to:
  - Attract professionals/ funding;
  - Inspire academic research;
  - Engage in public relations.
3. Connect practitioners, academics and advisors around field know-how.

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