

Chapter 8

Financing Agency for Social Entrepreneurship (FASE): An intermediary for hybrid financing, Germany

The Financing Agency for Social Entrepreneurship (FASE) is a financial intermediary providing hybrid financing to social enterprises. It uses a highly tailored, “deal-by-deal” approach in order to design innovative financing schemes that match the needs of social enterprises and impact investors. FASE objectives, rationale and key activities are presented together with the challenges faced in implementing the scheme and the impact it has achieved to date. Lessons learnt and conditions for transferring this practice to another context are also included.

Summary

The current challenges and opportunities in the European social finance market call for new initiatives. On the one hand, many social enterprises are not yet investment-ready and rely heavily on grants or donations, while searching for business models that generate revenue streams and attract larger, repayable forms of capital. On the other hand, funders are increasingly interested in impact investments, but face numerous hurdles – including the absence of a pipeline of investment opportunities allowing them to engage directly with investment-ready social enterprises. The Financing Agency for Social Entrepreneurship (FASE) was founded to provide new solutions for the social enterprise financing gap and mobilise hybrid growth capital across the often rigid boundaries between donors, investors and the public sector.

Using and creating innovative financing models that meet the various needs of all parties involved, FASE provides investment-readiness and transaction support to social enterprises with a strong positive impact. Many of these models are hybrid in nature, combining different types of financing instruments and funders in a single, tailored deal. These models acknowledge the fact that many social enterprises choose to operate as “structural” hybrids, with non-profit as well as for-profit organisational subsidiaries. Hybrid social finance is smoothing the way for social enterprises wishing to scale, opening up the full spectrum of funding sources and bringing all types of investors and risk-return profiles to the game.

In the current ecosystem, investor traction has to be actively built. Although a recent study on the German social impact investing market (Bertelsmann Foundation, 2016) finds that investment amounts have almost tripled – from EUR 24 million (euros) in 2012 to around EUR 70 million by the end of 2015 – the market is still nascent. Investor allocations for impact represent only a small fraction of the overall assets ready to be deployed. This is especially true of direct investments in early-stage social enterprises, which many investors perceive as too risky. This prompted FASE to establish a brand new network of 250 active impact investors and potential funders – from wealthy investors, philanthropists and foundations, to institutional investors, banks and public bodies – across various European countries.

In 2013, the European Commission (EC) launched an initiative to “support the demand and supply side of the market for social enterprise finance” (European Commission, 2013). FASE created and piloted several new financing and co-operation models in the context of this initiative (FASE, 2015), yielding a wealth of case studies and lessons learnt that offer powerful opportunities for replication.

Several case studies of German and Austrian social enterprises (FASE, 2013) show that deal-by-deal support can be a very impactful mechanism for mobilising social finance. As of December 2016, FASE has completed 20 transactions, channelling approximately EUR 8 million in new resources to the social finance ecosystem. Knowledge dissemination is another vital component: FASE attends or organises 30 sector events per year on average, investor panels and social finance roundtables, openly sharing its findings and reaching out to a growing number of social enterprises and impact investors. The Agency has also prepared more than 30 proprietary case studies and industry reports, and contributed to newspaper articles, industry reports and scientific papers. These insights, together with the financing models developed, provide powerful blueprints for social finance newcomers and experts alike.

Key facts

FASE was formally established in 2013 after a period of incubation by Ashoka¹ Germany. The idea was to create the first – and leading – financial intermediary in Germany designed to help early-stage social enterprises with strong positive impact raise growth capital. Today, FASE is registered as a private company and fully owned by Ashoka Germany. Its mandates for investment-readiness and transaction support now include both Ashoka Fellows and social entrepreneurs outside the Ashoka network. The FASE business model relies mainly on revenues generated from transaction support.

FASE is currently expanding and building a sustainable business model. The team comprises at least eight professionals with expertise in social finance and social entrepreneurship; business consulting and financial modelling; and venture capital and investor relations². A board of six senior advisors supports the team.

Along with other actors, FASE has helped expand the social investment market in Germany. With the exceptions of Ashoka and BonVenture, most key players were only established after 2009 (Bertelsmann Foundation, 2016).

Objectives

The main objective of FASE is to mobilise growth capital for early-stage social enterprises, to enable them to scale their impact. The main target market was initially Germany, with one early mandate coming from Austria.

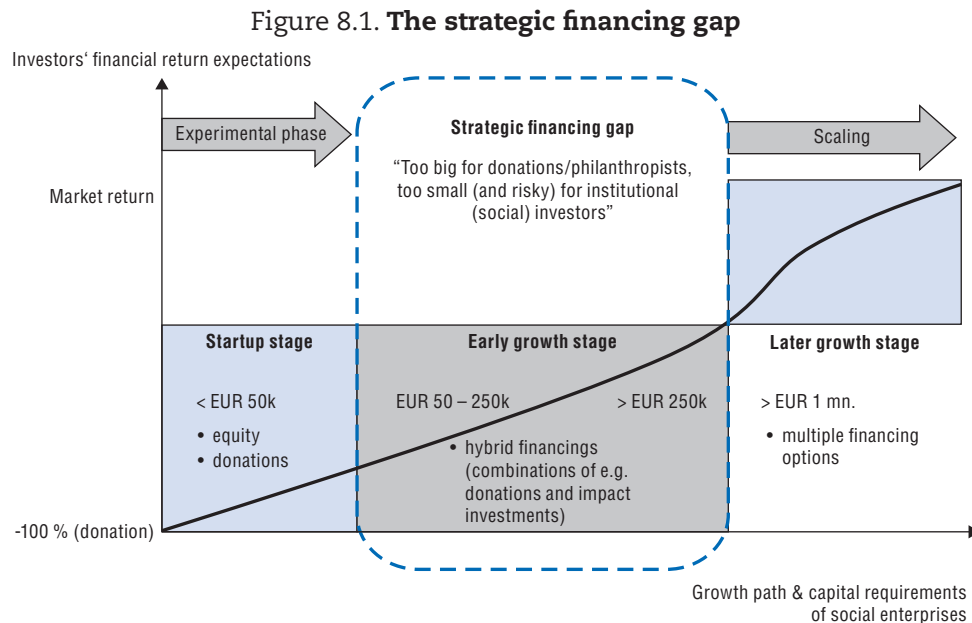
While FASE is positioned at the intersection of the social enterprise and impact investor spheres, activities have also spread to other policy areas. For example, FASE participates in initiatives fostering the entire impact investment market. As a member of the German National Advisory Board (part of the G7 Social Impact Investment Taskforce) as well as the European Commission’s Expert Group on Social Entrepreneurship (GECES sub-group WG1, “Improving access to funding”), FASE openly shares its practical experiences of financing social enterprises. Below is a brief summary of its core functions:

1. offers transaction and investment-readiness support to social enterprises
2. develops new hybrid financing models
3. builds a network of potential impact investors across the entire spectrum
4. initiates collaborations between different market players to advance the social finance ecosystem
5. participates in policy initiatives
6. disseminates knowledge through best-practice examples, events and case studies.

Rationale

A social enterprise’s lifecycle usually involves a diverse group of funders. Most projects initially rely on friends and family, or philanthropic seed capital; this is often referred to as “venture philanthropy”. In later stages, some social enterprises become very attractive investment candidates, and institutional impact investors, social venture funds or even banks are interested in being involved. However, many investors fail to meet the funding needs of a specific group of companies – early-stage social enterprises, which typically require EUR 100 000-500 000 to scale, and are generally unable to cover more than 75% of their operating costs with revenues. Most impact investors are waiting at the very end of the investment pipeline, for mature social enterprises that have already broken even. The result is a strategic financing gap for early-stage social enterprise finance: the required investment amounts tend to be too large for donations or philanthropic foundations, and too small and risky for institutional social investors. This calls for developing innovative financing strategies, securing more impact-minded investors, and building a pipeline of investment-ready social enterprises.

This market failure is often termed “the valley of death”: many social enterprises risk failing prematurely due to sheer lack of funding. Ashoka Germany launched FASE in 2013 to bridge the gap between capital supply and demand, so that social enterprises are able to scale their impact.



Activities

As illustrated in Figure 8.1., a complete set of activities and approaches is needed to address the social enterprise financing gap. The section below highlights two activities carried out by FASE – new collaborative funding models and a lean, transparent transaction management – that are probably the most innovative features and, therefore, offer a high value added.

New collaborative funding models: during the EU project (European Commission, 2013), FASE developed seven innovative collaborative financing models, which can be assigned to three basic categories: 1) tailored financing models; 2) hybrid co-operation models; and 3) innovative financing vehicles (FASE, 2016). The section below describes five models in these three categories.

Tailored financing models: this group includes three financing solutions that are specifically designed for hybrid social enterprises with both non-profit and for-profit subsidiaries (“structural hybrids”). In general, while non-profit legal entities are able to accept donations or public grants, the most appropriate financing instrument for-profit subsidiaries is typically quasi-equity (e.g. mezzanine capital). Two basic models fall within this first group of innovative financing vehicles:

Mezzanine capital with revenue participation and social impact incentive does not include loss participation, featuring instead a fixed interest rate coupled with a revenue share. The basic intention is to define a target return for the investor while capping the revenue share amount at the onset, enabling the social enterprise to develop in its first years. In the end, investors are entitled to catch up on their claims to achieve their target return.

Mezzanine capital with profit participation and social impact incentive follows essentially the same structure as the first, with the difference that it features a profit-participation mechanism combining a fixed interest rate with a share in the enterprise’s profit (earnings before interest and tax). Like the first model, this model can additionally feature a social impact incentive in the form of a one-time final payment dependent on the enterprise’s impact. To avoid any misinterpretations, this impact goal should be defined as precisely as possible.

Hybrid co-operation models

This second group features two solutions combining different types of investors in a single deal. This is another effective way of mobilising more capital for social enterprises: instead of having different financing “planets” with their own unique but separate cultures, an entire universe becomes accessible.

Equity donation with impact investment combines philanthropic funders with investors. A foundation, philanthropist or group of private donors contribute part of the overall financing by making a donation to the non-profit entity of a social enterprise with a hybrid organisational structure. This donation then increases the non-profit’s capital stock and enables it to hand over capital to the second entity, a fully owned for-profit subsidiary. This step opens up even more funding opportunities: to further support the financing of the for-profit subsidiary, impact investors can now inject additional growth capital, typically in the form of quasi-equity. This impact investing part is very flexible, and can also include features such as revenue or profit participation.

Crowd investment with impact investment combines crowd funders with investors. The crowdfunding is very beneficial as it is highly flexible: the crowd can either finance the non-profit entity through donations, or support the for-profit organisation with investments. The impact investment part is meant for the for-profit entity, and can be structured with the typical features and rights described in the first three models.

Innovative financing vehicles

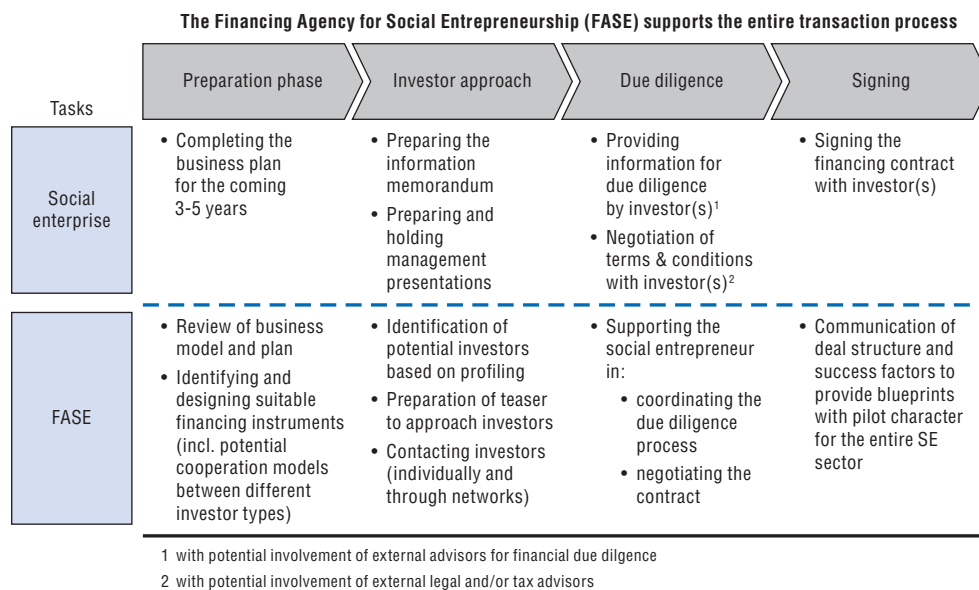
Two additional co-operation mechanisms address gaps in the social finance ecosystem, but require a separate financing vehicle. **The early-stage co-investment fund** is the most advanced such vehicle. The fund, which is currently in the pre-marketing stage, will address a systematic market failure – namely, how to secure more financing for early-stage social enterprises – by offering impact investors access to a diversified portfolio of early-stage deals. The fund will be linked to the FASE open pipeline of investment opportunities in social enterprises and will co-invest on the exact same terms and conditions defined by the respective lead investors. To enhance its attractiveness, the fund will be passively managed, and administered by an experienced partner. Moreover, it will apply for a newly established EU guarantee program (EU Programme for Employment and Social Innovation)³, compounding its potential to improve the risk-return profile for investors.

Lean transaction management

One of the key success factors of transaction management is to ensure a lean and transparent process. It has to be reliable, well-structured and efficient, for both social enterprise and potential investors in order to build trust. All participants need to know they will save time, money and hassle by engaging with an experienced financial intermediary, such as FASE. The process typically begins with initial discussions and ends with the successful closing of a transaction.

Figure 8.2. below illustrates the main steps of a transaction process from the perspective of a social enterprise. Even in a perfect setting, approximately six months may pass until the financing finally arrives in its bank account.

Several reports, case studies and articles provide concrete examples of the process.⁴ The third component of the FASE mission is to disseminate as much knowledge as possible in order to forge an evolving market for social finance.

Figure 8.2. **FASE lean transaction process management**

Source: FASE (2014).

Challenges encountered and impact

Quantifying the effects of a financial intermediary on the social enterprise finance market is by no means a trivial endeavour. Resolving a systematic failure requires putting together a full “package” of activities addressing several parts and players in the ecosystem. Where FASE is concerned, impact is best measured in terms of: 1) the number of transactions closed and total amount of financing channelled into the market; 2) the number of social enterprises advised on transaction support and investment readiness; 3) the size of the actively built investor network; and 4) the scope of knowledge disseminated through various communication channels.

As of June 2016, FASE has:

- successfully closed 14 transactions, channelling approximately EUR 5 million in fresh money into the social finance sector
- advised about 200 social enterprises on the nature, process and requirements of raising growth capital
- added over 250 current and potential impact investors as part of their network, including many first-time impact actors and established European players, from foundations and private philanthropists, through business angels, (ultra) high net-worth individuals, family offices and asset managers to institutional social investors, alternative banks, impact funds and venture capital firms
- signed 24 transaction mandates (14 closed transactions, 8 ongoing mandates for transaction support, and 2 terminated transactions⁵) and closed 3 investment-readiness packages.
- realised nearly EUR 10 million in total transactions to date, including EUR 5 million already closed (i.e. EUR 5 million in progress) (FASE, 2016).
- Among other noteworthy results, FASE has:
- organised and attended approximately 40 sector events, workshops and panels

- published over 30 articles, interviews and papers (most notably a study entitled *Achieving impact for impact investing – a roadmap for developed countries*, prepared by FASE, McKinsey and Ashoka, 2016)⁶.

Like any initiative striving to change existing market patterns, FASE faces a number of challenges, similar to those encountered by social enterprises, in developing a viable, sustainable business model that allows scaling the impact to a higher number of target groups and geographic regions. Given its limited team size and budget, the secret lies in bundling competences, resources and knowledge by building partnerships, joint ventures and co-operations. Recent initiatives include: 1) a financing partnership with a German alternative bank, providing a platform for engaging more foundations to finance social enterprises; 2) a social investment club, to be set up with a private bank; and (3) expanding FASE to other European regions, either as regional hubs or as joint ventures with local sector experts. FASE is also designing several other projects with its partners and other key market players. These include:

Pilot projects for pay-for-success models: FASE is at an advanced stage of piloting a direct pay-for-success model, the first of its kind in Germany, with a local social enterprise. Unlike a the concept of the social impact bond, the idea is to remunerate a social enterprise directly for the impact achieved by engaging a philanthropic player, who will pay the social enterprise based on pre-defined outcomes, thereby increasing the enterprise’s revenues and helping it become sustainable.

A crowd-investing platform for social enterprises: FASE is in an early stage of discussions with an experienced provider concerning the establishment of a “social” crowdfunding platform. FASE plans to contribute its unique expertise, network and mandate pipeline to this collaboration.

A SWOT analysis of FASE (Table 8.1.) may be helpful to better grasp the challenges faced by an intermediary in the current social finance ecosystem:

Table 8.1. **SWOT analysis of FASE**

Strengths	Weaknesses
<ul style="list-style-type: none"> ● Proven concept and impact ● Pioneer in deal-by-deal syndication ● Strong partnerships and network ● High recognition among social enterprises ● Track record of successful transactions ● Skilled and experienced team ● Proprietary network of impact investors from all financing “planets” ● Innovation leader for hybrid financing models ● Open-source approach: sharing blueprints and experiences for replication ● Social enterprise mindset and focus ● Independence from specific investor groups 	<ul style="list-style-type: none"> ● Still on the way to building a sustainable business model and breaking even ● Human resource-intensive business with transaction support on a deal-by-deal basis ● Long process to convince philanthropists and traditional investors to start investing for impact ● Limited budgets of social enterprises to pay for external services
Opportunities	Threats
<ul style="list-style-type: none"> ● Substantial demand for transaction support among social enterprises ● Increasing appetite of all types of investors for impact ● Significant potential to build a functioning social finance ecosystem in Germany ● Huge market opportunity in other European countries ● High level of transaction experience enabling scaling and expansion ● Innovative hybrid finance models as powerful blueprints for replication 	<ul style="list-style-type: none"> ● Most impact investors unwilling to invest in early-stage social enterprises ● Two dominant mental models of financiers: pure philanthropy, or investment model at market-rate or even higher financial returns ● High amount of time and effort required to build a functioning social finance market ● Risk of “impact-washing” ● Difficult replication in other countries with different frameworks or mindsets ● Adverse policy; legal or tax changes ● Dependence on social finance-friendly policies and frameworks

Lessons learnt and conditions for potential replicability

FASE has learnt many useful lessons in the past three years:

- Intermediaries who link potential investors and donors on the supply side with social enterprises on the demand side are a critical success factor for a thriving ecosystem.
- Significant barriers exist between the mental models of philanthropists and impact investors: social enterprises that provide a -50% to +5% annual return potential tend to be too commercial for philanthropists and too financially unattractive for most impact investors.
- Transaction costs are disproportionately high for social enterprises raising finance between EUR 100 000 and EUR 500 000, prompting institutional impact investors to move increasingly towards later-stage investments. The strategic financing gap for early-stage social enterprises could widen as a result.
- A pure market-based solution for financing early-stage social enterprises seems impossible in the current market. Most impact investors do not sufficiently value the positive external effects created by these social enterprises, and target financial returns at – or even above – market rates (J.P. Morgan and Global Impact Investing Network, 2015). Hence, public and philanthropic money will remain key to supplying early-stage social enterprises with sufficient capital to survive and thrive.

The deal-by-deal matching approach also provides important insights. These may serve as valuable sources for best practice, but also as a reminder of obstacles to overcome, for any player wishing to replicate the model.

- Intermediaries in the area of early-stage social finance struggle to develop an economically sustainable business model. Transaction costs for smaller deals are high, and many early-stage social enterprises also struggle to pay for external services. Hence, intermediaries need public or philanthropic money, in addition to proprietary earned income, to cover their costs.
- Matching investors and social enterprises on a deal-by-deal basis is time-consuming, but highly effective. This approach: 1) creates the most suitable combination of investors is created; 2) customises each investor coalition to match each social enterprise's specific needs; and 3) makes it easier to meet impact investors' specific sector preferences.
- A deal-by-deal approach allows impact investors from different financing “planets” to invest in the same social enterprise. FASE generally builds investor coalitions comprising two to four types of investors.
- A deal's financial risk-return profile is highly dependent on the social enterprise. FASE typically supports high-risk, early-stage social enterprises yielding financial returns well below risk-adjusted market-rate returns.
- A customised approach to financial instruments is key. FASE usually designs financing models based on quasi-equity (e.g. mezzanine) for hybrid organisations and on equity for entirely for-profit business models. These basic elements can then be combined with grants, loans, guarantees and co-investments, with additional features such as social impact incentives and profit or revenue participation agreements.
- FASE has observed three types of investor attitudes to impact return, focusing on: 1) impact only (typically grants); 2) impact first (reduced return expectations); and 3) finance first (market-rate return targets). Most investors FASE works with are impact-first investors:

they support the enterprise's social mission and expect a sustainable business model that can at least return capital, and ideally provide a low, single-digit interest rate.

- Stringent process management is imperative: when preparing a transaction, a financial intermediary must apply pressure on both social entrepreneurs and impact investors. This is one of the major benefits of hiring an intermediary: the entire process becomes much more efficient, reliable and time-saving.

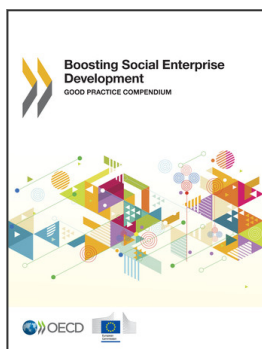
An overall lesson so far is that gaining access to the right type of capital and saving time during the transaction process allows social enterprises to focus on their mission: creating as much impact as possible for society.

Notes

1. Founded by Bill Drayton in 1980, Ashoka has provided start-up financing, professional support services and connections to a global network across the business and social sectors, as well as provided a platform for people dedicated to changing the world. Ashoka is the largest network of social entrepreneurs worldwide, with nearly 3 000 Ashoka Fellows in 70 countries changing ideas into practice. For more information, please visit www.ashoka.org.
2. For more information, please visit www.fa-se.de/en/.
3. European Investment Fund, "EaSI Guarantee Financial Instrument", http://www.eif.org/what_we_do/microfinance/easi/.
4. For more detailed and practice-driven information, please visit <http://fa-se.de/en/press-links/> for papers and articles (English and German) and <http://fa-se.de/en/case-studies/> for detailed case studies with social enterprises.
5. In the course of the transaction process, one enterprise became insolvent and the other realised that it was too early-stage to raise growth capital.
6. A full list of publications (in German and English) can be found on the FASE website at <http://fa-se.de/en/press-links/> and <http://fa-se.de/presse-links/>.

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