Building the Social Enterprises of the Future with Hybrid Financing

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Globalization, long-term demographic trends, changing consumer preferences, and the state of public finances are collectively driving the emergence of an integrated social capital market for the first time in human history, currently valued at US$46 billion. Nonetheless, the social sector remains highly fragmented. This lack of coherence serves to hold back investment by raising costs and complexity.

Social entrepreneurs also need money for starting and scaling their ideas, but existing funding solutions are often imperfectly suited to their needs. Chris West, director of the Shell Foundation and a long-time supporter of social enterprises, commented: 'One of the barriers social enterprises face in reaching scale and sustainability is the 'valley of death' that exists between securing grant funding and investment capital. To bridge this gap, we need innovative tiered capital structures that blend 'patient capital' with debt and equity.'

Building Impact Businesses through Hybrid Financing: Special impact starter edition, a new report released by Impact Economy last week, examines leading social enterprises operating in a number of fields ranging from alternative energy to solid waste management and explores how these efforts can be more effectively and efficiently funded for growth and greater impact. It is meant as a companion to Impact Starter, a new platform to help get social entrepreneurs started.

A key implication emerging from the work is that successful social enterprises can use hybrid financing to drive greater impact. Grants remain the best way to seed a social enterprise, but grants tend to become insufficient in providing the capital required for the venture to scale if it achieves initial success. Hybrid financing models use some combination of up to four forms of capital (eg grants, debt, equity, and mezzanine or convertible capital), as well as a variety of possible financial instruments such as internal credit enhancement through subordination or reserves, or external credit enhancement via letters of credit.

Time also plays a hugely important role in these structures: hybrid financing can be synchronic (or tiered), combining for example grant and non-grant sources of capital simultaneously to fund the joint expansion of profitable elements and the optimization of unprofitable elements of the value chain and reduce risk. Or they can be diachronic, with hybrid funding unfolding over time, typically beginning with grant funding and then 'graduating' to equity and debt funding as the venture achieves critical mass.

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Transformative progress on a number of issues needs to be the shared objective of innovative hybrid financing strategies. Some of these issues, which are covered in the report, include the fact that only 40-70 per cent of all the urban solid waste in developing countries is collected; open dumping and burning of waste continues to be the norm rather than the exception; and a country like Peru alone has 108,000 informal waste pickers who often live on toxic dumps. What's more, 2.5 billion people around the world do not even have toilets.

While the poor spend US$433 billion per year on energy, 1.2 billion people still lack access to electricity. India's new government led by Narendra Modi recently made waves by planning to harness solar power to enable every home to run at least one light bulb by 2019. With 400 million people currently lacking electricity in India, fresh approaches will be needed to translate this ambitious goal into reality, and a strategic combination of patient or long-term capital as well as grants.

Jürgen Griesbeck, founder and CEO of *streetfootballworld*, the focus of one of the case studies in the report, commented that hybrid financing strategies offer 'important components to transform entire industries. Like subsidies or public research grants in the private sector, donations are highly important to the social sector to fund innovation and to support hard-to-monetize thematic areas.' Hybrid financing strategies 'can help to bridge the gap: from the current reach of clients in the social sector to all of those that are not yet served,' said Griesbeck.

With 270 million people around the world playing football, which also happens to be a great way to reach at-risk youth, and the opening match of this year's FIFA World Cup only 10 days away, football-for-development as practised by streetfootballworld is one of the many areas where it is time to unleash the power of hybrid financing. Combining philanthropic and commercial capital can help achieve a step change in impact, and build and finance the social enterprises of the future.

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