

S O C I A L

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I N G

:

**SOCIAL IMPACT  
INVESTING:**

Financing Social Change

F I N A N C I N G

S O C I A L

C H A N G E

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## INFOBOX 1

### Social Impact Investment Taskforce and National Advisory Board:

#### *Mission and mandate*

The Social Impact Investment Taskforce (SIITF) was established during the United Kingdom's G8 presidency in 2013. It is made up of state and civil society representatives of the member countries. This independent public-private Taskforce was mandated by British Prime Minister David Cameron to formulate recommendations for the constitution and further development of international markets in which supply and demand for social impact investment capital can be effectively brought together.

Sir Ronald Cohen chaired this Taskforce. He is the founder of the Apax investment group and chair of the UK Taskforce on Social Investment, which was active between 2000 and 2010. The German government was represented within the Taskforce by Susanne Dorasil of the Federal Ministry of Economic Cooperation and Development (BMZ). Germany's civil society sector was represented by Dr. Brigitte Mohn of the Bertelsmann Stiftung.

Each of the G8 states, including Germany, participated in the creation of National Advisory Boards (NABs) at the national level. In Germany, this board was composed of representatives from the social sector, financial sector, foundations, academia and public sector (see page 7). The German NAB provided the international Taskforce with information on the specific circumstances in Germany and its members' experiences with private investment capital within the social welfare system. In addition, it offered information on experiences related to German social impact investment initiatives in developing and emerging countries.

The members of the German NAB were invited to participate by the Bertelsmann Stiftung in cooperation with the BMZ and the Federal Ministry of Family Affairs, Senior Citizens, Women and Youth (BMFSFJ). Dr. Brigitte Mohn served as chair of the German NAB. While preparing this final report, participants met in various working groups (strategy and coordination, asset allocation, investability, impact analysis, international development cooperation) during the period between January and September 2014. The Bertelsmann Stiftung provided conceptual guidance and organisational support for the NAB in Germany.

## PREFACE

### Dr. Brigitte Mohn



Germany is facing costly challenges. Social, demographic and ecological developments require us to not only support proven solutions within our social sector, but also to test new ideas and approaches. If these prove to be successful and effective, the next step must be to ensure that they are implemented in a manner befitting the existing system. This is impossible without the strong commitment of the professionals and volunteers working within our social sector. In order to ensure they have the necessary resources available to them, I believe the financing options in this sector must be expanded.

Over the last year, an international working group that emerged from a meeting of the G8 countries in summer 2013 has been intensively investigating the potential development of additional financing sources for the social sector. Its focus has been on the mobilisation of private investment capital in order to finance the most promising new models for solving social problems. The novelty of this approach lies in starting with a shared understanding of the problem, defining common goals, and seeking to create solutions through a division of labour involving various sectors. By drawing on private capital, we can expand our financing options. In this way, the social systems of developed welfare states can be strengthened. Moreover, using similar approaches can also support developing and emerging countries.

Special thanks go to the members of the German National Advisory Board for their willingness to examine the use of social impact investing both within Germany and in overseas investments with German origins. It is of great significance that actors from the social sector, financial sector, foundations, academia and the public sector were able to agree on looking towards a shared goal—the financing of positive social impact. Different worlds came together here and were willing to learn from one another.

The main conclusion of the NAB's work is that the potential of social impact investing lies above all in promoting prevention, innovation and scaling-up in the German social sector. In addition, there is both a need for and an interest in social impact investment which originates in Germany and is targeted at developing and emerging countries. Internationally, there are already a number of established actors and instruments that facilitate social impact investing in developing and emerging countries. By sensitising German investors to this issue and promoting an international exchange of experiences, we can make a contribution to further market development. At the same time, the German domestic market is in an early innovation phase. Looking forward, there is a need for a systematic proof of concept in those parts of the social sector where the funding gaps are greatest.

Each day a huge number of motivated and talented people work on the development and dissemination of solutions to social problems, be they based in existing social purpose organisations or in start-ups. Socially motivated investors are looking for new forms of impact-oriented activities. New advisory services are appearing with the aim of bringing together demand and supply. To make genuine progress, these investors, investees and intermediaries need targeted support, including an enabling policy environment.

We are at the beginning of a long journey. I am pleased that we are on this path together and very much hope that this report will serve as a starting point for further debate and decisive action.



**Dr. Brigitte Mohn**

Chair, National Advisory Board (NAB) Germany

Member of the International Social Impact Investment Taskforce (SIITF), established during the UK Presidency of the G8

## MEMBERS OF THE NATIONAL ADVISORY BOARD GERMANY

<b>Dr. Brigitte Mohn</b>	Bertelsmann Stiftung ( <i>chair, international Taskforce member</i> )
<b>Susanne Dorasil</b>	Federal Ministry of Economic Cooperation and Development ( <i>international Taskforce member</i> )
<b>Dr. Georg Allendorf</b>	Deutsche Bank
<b>Havva Avci-Plüm</b>	Ministry of Labour and Social Affairs, North Rhine-Westphalia ( <i>observer</i> )
<b>Dr. Ingo Ballschmieter</b>	Bertelsmann Stiftung
<b>Jake Benford</b>	Bertelsmann Stiftung
<b>Maren Bianchini-Hartmann</b>	BMW Stiftung Herbert Quandt and Eberhard von Kuenheim Stiftung
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<b>Florian Erber</b>	Social Venture Fund
<b>Jörg Freese</b>	Deutscher Landkreistag
<b>Dr. Markus Freiburg</b>	Financing Agency for Social Entrepreneurship (FASE)
<b>Thomas Goldfuß</b>	GLS Bank
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<b>Dr. Thomas Jetter</b>	Soros Economic Development Fund
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<b>Dr. Nannette Lindenberg</b>	German Development Institute
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<b>Wolfgang Meyer</b>	Sozialwerk St. Georg
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<b>Ingo Weber</b>	The GIIN Europe and LeapFrog Investments
<b>Melinda Weber</b>	Impact in Motion
<b>Volker Weber</b>	Forum Nachhaltige Geldanlagen
<b>Berénike Wiener</b>	Association of German Foundations
<b>Sylvia Wisniwski</b>	Finance in Motion
<b>Bettina Windau</b>	Bertelsmann Stiftung
<b>Dr. Claudia Wohlleber</b>	Diakonie Deutschland – Evangelischer Bundesverband

## EXECUTIVE SUMMARY

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- ▶ Social, demographic and environmental developments have triggered a search for new sources of financing in order to develop and implement solutions to social challenges; this search is taking place internationally as well as in Germany.
- ▶ Social impact investments (hereafter referred to as SII), known in Germany as “*Wirkungsorientiertes Investieren (WI)*”, are investments whose focus goes beyond purely risk and return. Rather, they intentionally target specific social objectives along with a financial return and measure the achievement of both. The core idea behind SII is thus to build a bridge between positive social impact and the allocation or deployment of capital.
- ▶ In Germany, SII offers the opportunity to channel “*impact-seeking*” capital into areas of the social sector where the need is greatest.
- ▶ Germany’s social sector requires investments for activities related to prevention, innovation and scaling up. Despite the country’s highly developed welfare system, there are significantly less financial resources available for these types of measures compared to the statutorily funded areas of the social system.
- ▶ The use of SII should always be complementary to existing financial resources and should not trigger a debate over the distribution of public spending or indeed cuts. Rather, SII should broaden and strengthen the social sector’s financing system. Once impact has been demonstrated, measures financed through SII can be considered for guaranteed financing as codified in social law. In particular, the use of SII should not lead to the privatisation or commercialisation of state-guaranteed public services.
- ▶ The German market for social impact investments currently finds itself in a phase of innovation driven by pioneers in the field. The next step towards integrating SII into the social sector’s financing system will require a systematic proof of concept in one or more selected fields of the social economy.
- ▶ For a systematic proof of concept to occur, appropriate support structures for funding recipients, funding providers and intermediaries are required. Philanthropic capital will play a key role in the innovation and proof of concept phases.
- ▶ At this early stage it is necessary to create knowledge-building and networking opportunities to foster the development of a community of potential investees. Existing business models within the social sector must be developed in such a way as to absorb investment capital while start-ups in the social sector need to be supported and promoted in a more targeted way.



- ▶ State supported SII funds, perhaps with a regional focus, can create new incentives for the implementation of prevention, innovation and scaling up activities in selected areas of the social sector.
- ▶ With regard to investors, risk-sharing measures for pioneering social investors will be necessary during the innovation and proof of concept phases. Public promotional banks and foundations can play an important role in this area.
- ▶ In terms of investments outside of Germany, the KfW Development Bank and the Deutsche Investitions- und Entwicklungsgesellschaft (DEG) are particularly active on behalf of the federal government, aiming, among other things, for positive social and environmental impact in developing and emerging countries.
- ▶ Internationally, there are already a number of established actors and instruments facilitating social impact investments in developing and emerging countries. Sensitising German investors to these activities and enabling an exchange of information about first-hand experiences could help to advance the market further.
- ▶ Investors are showing a growing interest in the social impact associated with investment capital, suggesting a basic affinity with the aims of SII. Although the degree to which the investment community is ready to invest in SII has not been comprehensively researched yet, a current and ongoing survey offers some initial empirical findings:
  - **Foundations** see SII as an interesting new investment option while wealth managers remain critical of below-market rates of return. In terms of grant-giving, an investment with positive returns is fundamentally difficult, as the profit would create an (unintended) business operation. The provision of legal certainty through appropriate regulation is thus urgently needed. This is particularly true for regulations pertaining to taxes and foundations.
  - **Private investors**, especially high net worth individuals, see SII as a good way to achieve positive and measurable social impact with small initial investment budget. In this regard, private investors are willing to accept below-market returns for significant periods of time. At the same time, however, there is a relatively small number of suitable products or robust investable propositions currently available. The opportunity for investors to personally identify with their investment and to see their impact at the local level will also make SII interesting for retail investors in the future.
  - For **professional investors**, the overall understanding of the interplay between risk, return and social impact is of crucial long-term significance. The integration of SII into multi asset portfolios can only be effected on the basis of such an understanding.
- ▶ Going forward, it is investors and financial intermediaries in particular who will need to acquire the necessary competences to advance the systematic development of impact investment vehicles as required by the demand in the social sector.

## INFOBOX 2

### The OECD and the international development of social impact investment

The Organisation for Economic Cooperation and Development (OECD) in cooperation with the Social Impact Investment Taskforce (SIITF) and the National Advisory Boards (NABs) is currently preparing a broadly conceived study on the role of SII within the financing systems of developed industrial countries. To this end, the needs of the social sectors of OECD countries are being closely examined. More specifically, the study examines the evolution of this approach to financing and its visible trends, drawing a parallel with the evolution of venture capital markets. As a result, the study further develops the conceptual understanding of SII and proposes several relevant methods of data collection and presentation. More significantly, however, the study makes proposals for creating an enabling policy environment for SII markets.

An inaugural OECD paper on the topic of SII supported by the Bertelsmann Stiftung appeared in June 2014 entitled “*New Investment Approaches for Addressing Social and Economic Challenges*”.

## INTRODUCTION

### *The search for new resources*

Fewer citizens, more individuals with social needs and yet empty coffers: The consequences of this predicament are felt in particular by Germany's municipalities and their partners in the social sector. As a result, the need to develop new solutions is greater than ever. At the same time, Germany is not alone in facing the challenge of rising social costs on the one hand and a decline in funding options to tackle them on the other. It is against this background and at the initiative of the British government that the topic of social impact investing found its way onto the agenda of a meeting of the G8 countries in June 2013.

SII – in German, “*Wirkungsorientiertes Investieren (WI)*” – are investments whose focus goes beyond risk and return. Instead, they intentionally target specific social objectives along with a financial return and measure the achievement of both. This bridge which SII builds between the financial and social sectors should be constructed in the public interest and should contribute to a sustainable society by strengthening the social sector.

In the German domestic context, and to a large extent around the world, financing aimed at creating social impact in this way is still in its infancy. Pioneers among funding providers, funding recipients and intermediaries are pursuing this approach with considerable innovative flair and are already reporting their initial results. However, in the broader German social and financial sectors, in the world of foundations, in academia and in the public sector, this approach to financing is not yet widespread. Similarly, there is comparably little evident activity of German investments in developing and emerging countries. That said, certain financing instruments already in use may be suitable for both the German domestic market and investment in developing and emerging countries. Important insights can certainly be derived from their past use.

Can social impact investing strengthen Germany's social sector? How can SII originating in Germany and aimed at developing countries be strengthened? This report offers an initial assessment of this funding approach within the German context. It is guided by the following questions:

**I: Demand for funding:**

*Where exactly within Germany's system of social services and among socially motivated organisations is there a need for social impact capital?*

**II: Supply of financing:**

*Under what conditions can social impact investment capital be mobilised to finance social impact in Germany and in developing and emerging countries?*

**III: Analysis and communication of impact:**

*How can the factors driving success in social programmes be captured and communicated in order to attract private actors to the SII sphere?*

**IV: Enabling conditions:**

*What support structures are necessary in order to facilitate or strengthen the use of SII both domestically (in Germany) and internationally (investments originating from Germany)?*

The answers to these questions will provide an initial assessment of SII's potential within the German context and outline its current limitations. On this basis, several recommendations will be made with the aim of developing and anchoring SII as a method for financing social outcomes both at home and abroad.

## CHAPTER I.

### The demand

#### *Prevention, innovation and scaling up in the German social sector*



Germany is facing costly demographic and social challenges. Today the expenditure for health, education and social issues is rising faster than GDP – in the case of forecasted health spending through 2025, perhaps even twice as fast.<sup>1</sup> Even in terms of providing a consistent level of social services, funding gaps are already visible today. Representatives of the German social sector attest to the sector's progressive underfunding, confirming the suspicion that current funding levels will be insufficient in the long term.<sup>2</sup> The consequences of these emerging cost pressures are witnessed daily by socially motivated organisations.<sup>3</sup> Grants are being reduced or discontinued and service payments are being kept to a minimum. These circumstances are placing considerable pressure on all the parties involved to square

the growing demand for social services with increasing budget restraints – whilst at the same time increasing social impact. Associations representing social organisations point to the fact that there are limits to rationing and efficiency gains for the types of services they deliver; at the same time, their own resources, used in the past to fill funding gaps, are virtually exhausted.

1 Accenture (2013)

2 Accenture (2013); Bertelsmann Stiftung (2013)

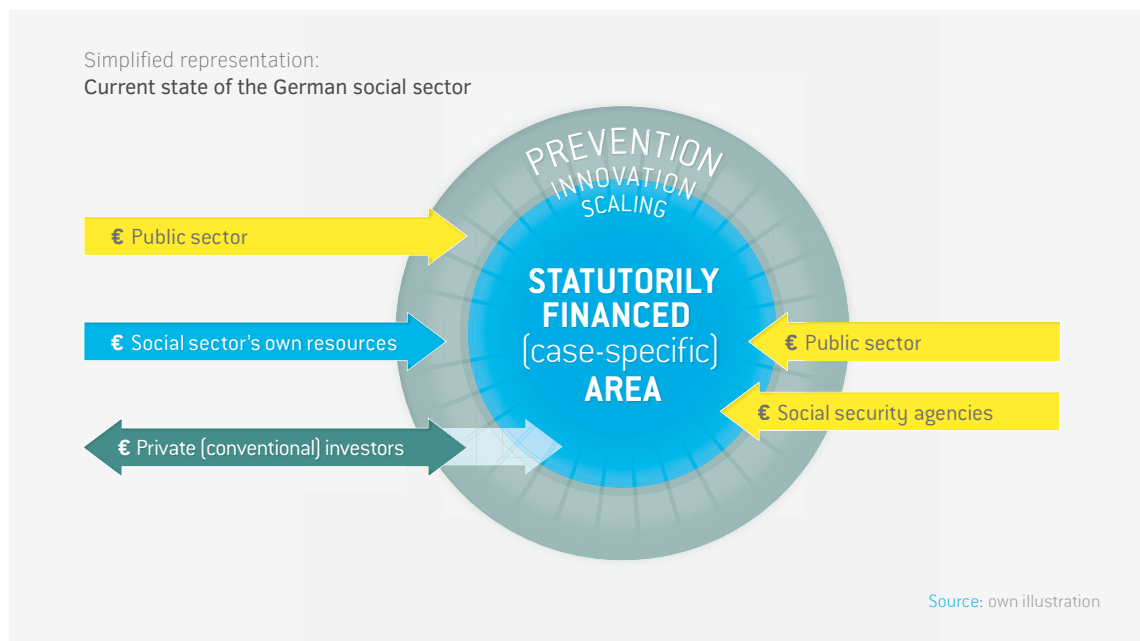
3 For the definition of a socially-motivated organisation, see Spotlight 3, p. 26.

### Prevention, innovation and scaling up activities are underfunded

Given the growing demographic and social challenges and changed financial situation, there is an obvious shortfall in funding for preventative measures that can avert downstream costs, for the innovation needed to develop new solutions, and for efforts to roll out proven approaches on a larger scale. In the private sector, the need for investment aimed at the targeted development of new products and services is undisputed – it is in fact a recognised prerequisite for a sustainably successful business model. Yet in the social sector, where the market environment is due to change radically over the coming years, there is a lack of financial resources available to develop the targeted and forward-looking models needed to meet future challenges. Indeed, socially motivated organisations' latitude for action is increasingly being restricted. Such bodies compete for limited financial resources and operate under high pressure to be as efficient as possible. This pressure rarely leads to improvements in services and business models or stronger social impact, and ultimately does little to create a better social welfare system.

The following graphic illustrates the problem of underfunding in the social sector and distinguishes between two areas: first, the area of so-called 'guaranteed financing', in which claims to services and thus access to public resources are supported by a statutorily anchored social welfare system; and second, the areas of prevention, innovation and scaling, largely organised and financed on a voluntary basis.

Fig. 1: Current financing sources in the German social sector



In comparison with international standards, the German welfare state has developed a mature welfare system that offers high-value social security and support services to citizen beneficiaries on the basis of an individual legal right (see inner circle). German social law functions primarily as an individual entitlement to services in this case. Specifically, this means that implementation takes place across the “*Problem recognition – Diagnosis – Classification – Disbursement*” process chain. This type of so-called ‘case-specific’ work is to a large extent fully financed by the existing system; from the perspective of social sector service providers, the challenges in this context do not primarily derive from a lack of financial resources, but are rather the result of the need to increase efficiency and efficacy in the use of existing resources.

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### **Prevention**

However, prevention is accomplished through so-called ‘*non-case-specific*’ work. Through prevention, individual services or even the overall system of services can be arranged so that an aggravation of the current problems can be avoided; thus, either the use of additional services becomes unnecessary or transition to costlier forms of support can be avoided or delayed. This can include services provided or measures taken for the benefit of multiple categories of people in the social environment; measures for coordinating, facilitating and managing networks; or measures that have a bearing on multiple budgets and areas of law. However, in many cases, prevention can only be accomplished through new types of service provision that cut across traditional dividing lines between funding providers, ministries and levels of government. While prevention is expressly provided for in a number of social legal codes, the further development of the social sector towards a prevention-focused system is constrained by the underfunding of these non-case-specific measures and services.

### **Innovation**

Innovation within the social sector refers to the development of new ideas, services and models able to address societal problems. The concept of innovation can refer to wholly new ideas on the one hand, and to existing products, services or processes that have been adapted to fit new conditions on the other hand. Likewise, solutions that are already established in one context, be it temporal, geographical or within a specific subject-area, can be regarded as innovative in a different set of circumstances. According to this understanding, innovation in many social sector service areas is currently financed merely out of whatever latitude or flexibility exists in the remuneration provided by funding providers, while legally entrenched funding mechanisms for innovation tend to be limited to certain subject areas. Moreover, even when an innovation is successful, there is no guarantee that it can be rolled out on a larger scale. Finally, social law does not provide funding for start-ups – potential social entrepreneurs are for the most part referred to general economic support programmes designed for conventional for-profit organisations instead. These support programmes are typically inaccessible to non-profit organisations.

## Scaling

At various points in German social law provisions are made for the annual allocation of resource funding directed towards the innovative development of preventative approaches (e.g. § 135 Social Security Code III, § 3 and § 4 Social Security Code IX). Moreover, numerous foundations and other organisations in Germany are focused on making social services function more effectively. In many cases, these efforts also produce successful pilot or flagship projects with demonstrated impact. These are, however, often not taken to the next logical level of implementation. This is often due to the predominance of project-based funding and resulting lack of resources following the conclusion of the pilot phase. The implementation of a consistent strategy to scale up high-impact projects could avert the widespread need to continually reinvent the wheel and would lead to a considerably more effective use of time, energy and financial resources.<sup>4</sup>

## Your money, my savings

A further challenge for the financing of prevention, innovation and scaling up activities arises from the fact that expenditure reductions achieved are often reflected in the budgets of entities that have not “invested”, rather than in the budgets of those that did. This discrepancy between costs and social returns creates a system of countervailing incentives. Why should the Ministry of Justice invest in recidivism reduction among ex-offenders if the positive financial effects accrue to the social security agencies, for example? And why should a socially motivated organisation invest in home-based care for the elderly in order to delay or even prevent the transition to more costly forms of care if the positive financial effects accrue to the long-term care system, the municipal budget and the housing industry?

## Regulated and less regulated...

Against this backdrop, new sources of funding and new funding approaches are becoming increasingly relevant to socially motivated organisations. And yet, access to credit and capital markets will become more difficult for start-ups and existing organisations alike if they cannot offer sufficient equity and security if their expectations of future earnings are not reasonably secure and if they cannot demonstrate an acceptable banking history. Accordingly, funding difficulties emerge when socially motivated organisations that are strong and forward-looking implement a new service concept or business model or wish to roll out proven solutions on a new, larger scale – regardless of the anticipated positive social impact. It is precisely this problem that leads socially motivated organisations to the conclusion that they are not so much hindered in increasing their impact by a lack of ideas but rather by a funding-related problem of implementation.



The limitations of case-specific guaranteed financing (inner circle) within the social services and social insurance systems clearly demand an expansion of non-case-specific funding for the support of prevention, innovation and scaling up activities (outer circle). Underlying this need is a widely acknowledged increase in demand for social services as well as pressure to make services more efficient and effective in order to prevent future expenditure. While competition within the social sector is rising, placing increasing pressure on providers to improve efficiency, this competition often fails to lead to the creation of new business models with improved types of service delivery that expand and strengthen the statutory welfare system. Against the background of social, demographic and fiscal trends, the funding conditions for prevention, scaling and innovation appear suboptimal – even unsustainable – going forward. The development of prevention, innovation and scaling up activities must be better supported through new funding conditions in the future.

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### **The crux of the issue**

The evolving character of demand is visible in numerous areas of the social sector. It can be illustrated in two areas of significant social relevance: “*Vocational education and work*” and “*support and care for the elderly*”.

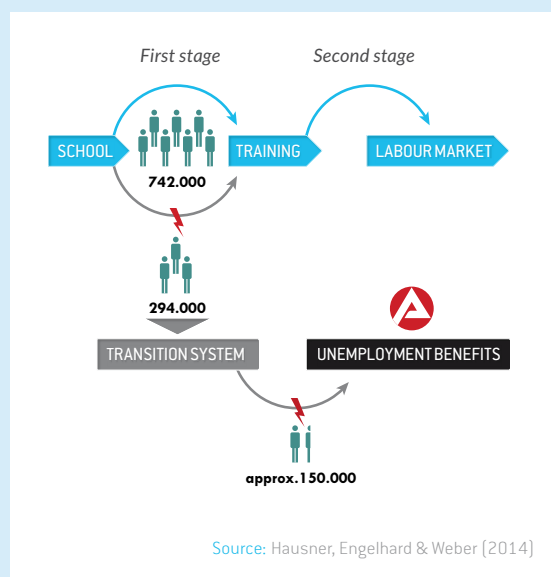
## SPOTLIGHT 1

### Vocational education and work

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Comparison across OECD countries shows that Germany's overall unemployment rate is relatively low and its economy is relatively strong. Nevertheless, as a share of overall unemployment, the country has an above average long-term unemployment rate of 46.2% in comparison to an OECD-wide rate of 33.6%.<sup>5</sup> Analyses show that the main cause of long-term unemployment lies in the lack of training of young people; while the individual risk of unemployment is closely related to a person's acquired level of work qualification. In 2011, 45% of all unemployed individuals had no qualifications and only 14% of people without a qualification were employed,<sup>6</sup> while 17% (7.9 million) of people of working age<sup>7</sup> were without vocational training and not in school, study or training at that point.<sup>8</sup> Every year, an additional 150,000 young people leave the education system permanently without a vocational qualification. As Figure 2 shows, about 294,000 school-leavers in 2011, or around 30% of the age cohort,<sup>9</sup> failed to take the step from school to either vocational training or the labour market.

Fig. 2: Transition into the labour market (2011)



The transition system consists of educational programmes that enable young people without a degree to complete their general-education diplomas and to find a vocational focus, fulfilling the compulsory school attendance requirement part-time if necessary. These education programmes impart basic vocational skills but do not provide recognised vocational degrees—thus, the transition system can be described as expensive, inefficient and unjust: only around 50% of all participants were subsequently successful in entering the vocational training marketplace. Thus, this path is associated with a considerable loss of time for these participants. More problematic, however, is the other half of participants (about 150,000 young people per year) for whom the transitional system's measures are ultimately ineffective as they, despite significant personnel and time investment, remain permanently without a vocational qualification.<sup>10</sup>

This lack of vocational education of young people produces high long-term costs for the state:

- Additional expenditure on the part of social security institutions and public budgets (2012: €53.8 billion, €25.2 billion of which was borne by local authorities).
- Lower revenues through lost wages, income tax or social security contributions (2012: €24.1 billion).<sup>11</sup>
- Indirect cost factors such as increased health and crime-related costs in addition to costs associated with active labour-market policies.

In this context, investments in scalable measures with proven impact, particularly those offered on an as-needed basis to young people at risk of falling out of the transition system, would be of interest. In particular, prevention and non-case-specific work (that is, investment in systems, collaborations and structures that are not funded under the prevailing financial and performance logic) can positively contribute to breaking the chain of causation between the lack of vocational training and long-term unemployment.

5 OECD (2013)

6 Weber & Weber (2013)

7 15 to 64 years

8 Bundesagentur für Arbeit (2013)

9 Klemm (2012)

10 Autorengruppe Bildungsberichterstattung (2008)

11 Hausner, Engelhard & Weber (2014)

## SPOTLIGHT 2

### Support and care for the elderly

Care for the elderly in Germany is facing multifaceted difficulties: On the one hand, there is already a “care gap”, which is steadily growing – the number of people needing care will have increased by 50% by 2030, while the number of people that work in the care industry is slightly decreasing. In 2030, there will be fewer than 500,000 people employed full-time to provide care services.<sup>12</sup>

In addition to this care gap, the system of care itself focuses primarily on somatic symptoms in the classification of care levels and the related payment of nursing allowances. It is expected that this situation will be mitigated somewhat once the ongoing transition to a new definition of ‘long-term care needs’ will be completed, as the current three graded levels of care will be expanded to five by 2017. The new definition will also include important non-somatic aspects; for example, the needs of dementia sufferers for general care will receive stronger consideration. However, this shift changes very little in the structure of care financing that would allow long-term care providers to invest in the prevention of serious future problems and it does not increase the financial flexibility to develop new care or care-giving approaches. Due to growing demand for long-term care, costs will continue to rise.

The principle of “outpatient before inpatient” is often cited as a goal, yet the structure of financing and remuneration for long-term care provides little in the way of incentives in this area. Currently, annual costs for long-term care amount to about €42 billion, to which the social long-term care insurance contributes a little more than half. Dementia-related diseases are one of the most important drivers of demand for residential care, accounting for 43% of admissions to residential care facilities.<sup>13</sup>

Going forward, the prevalence of dementia will increase further as a result of the ageing population. It is estimated that in 2030, of a population of 77.4 million people, 2 million will be living with dementia in Germany; in 2050, this could even rise to 2.6 million people out of a total 69.4 million residents – almost four out of every hundred.<sup>14</sup> Interventions aimed at keeping the sufferer active and mobile and slowing the progression of the disease are not frequently available, and are either not at all or only partially subject to reimbursement through long-term care insurance.

The negotiation of contracts between service funders and service providers is largely determined by cost factors and typically takes place independently of the outcomes achieved by individual care providers.<sup>15</sup> In addition, quality assessments are often concerned with structure and process quality, paying little or no attention to the level of impact achieved.<sup>16</sup>

In this context, investments that are not associated with individual cases and which give long-term care providers the opportunity to develop networks and structures that interrupt spiralling care needs in residential treatment, appear promising.

12 Bertelsmann Stiftung (2012)

13 Bundesministerium für Familie, Senioren, Frauen und Jugend (2002)

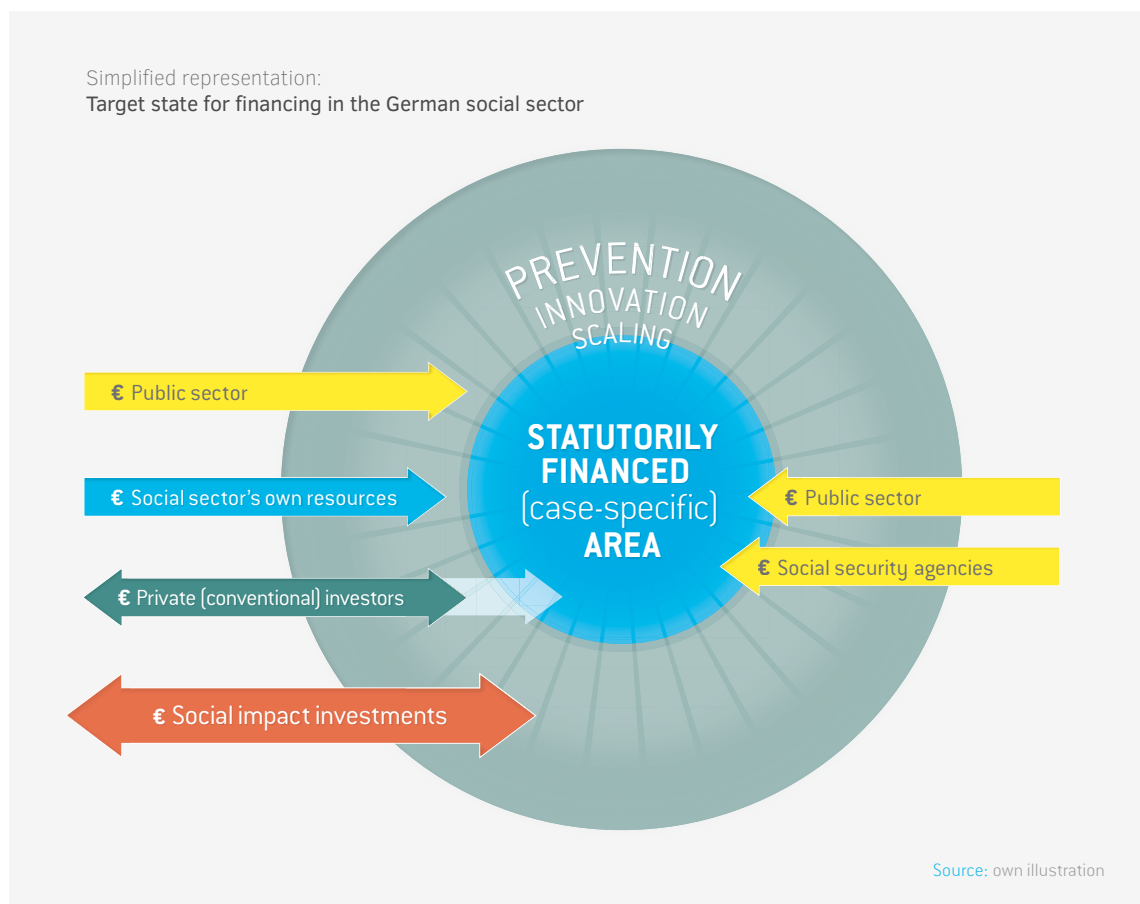
14 Berlin-Institut für Bevölkerung und Entwicklung (2011)

15 Schröder (2000)

16 VDAB (2014)

Within the two areas of the German social sector spotlighted above, a significant volume of services supported by guaranteed financing are available. There is no prima facie lack of financing in these arenas. However, rising costs and efficiency pressures have a negative impact on the efficacy of services in both cases. In the area of training and work, the transition system put in place to help undereducated young people transition into the market place has only been successful for about 50% of participants. In terms of long-term care for the elderly, a financing structure focused on individuals leaves social service providers with very little flexibility to engage in the development or improvement of services. Nevertheless, modes of their services delivery do exist in both of these social sector arenas that are of greater proven impact, but these are only sporadically implemented as a result of the logic underpinning the prevailing financing practices. New financing approaches could potentially create a rise in effectiveness in the face of cost and efficiency pressures. In addition, improved service delivery could reduce long-term costs in both cases. Similarly, developed service-delivery models that have already proven to be more effective could be scaled up, thus benefiting a much larger group of benefit recipients. The following figure illustrates the positive effects made possible through the implementation of new financing approaches in the social sector. By making new sources of financing available in the area of non-case-specific services (outer circle), a broader field of action emerges for the financing, promotion and implementation of prevention, innovation and scaling up activities.

Fig. 3: Target state for financing in the German social sector



## CHAPTER II.

### The supply

#### *Risk, return, and positive social impact: SII as a concept and in practice*

While commissioners and socially motivated organisations are in need of more resources for prevention, innovation and scaling, German asset managers oversee assets of approximately €1.7 trillion, or more than 30 times the annual turnover in the German social sector.<sup>17</sup> These resources are used to finance governments and companies, brokered through investment classes such as bonds or equities. The financial industry traditionally responds to market demand for funds with the development of new financing instruments. An example of such a response is the development of venture capital (VC), which emerged as a response to the need for risk capital in the flourishing high-tech sector of the 1970s and 1980s. As the demand could not be met by existing asset classes such as equities and credit, the development of a new asset class and the successful collaboration between the high-tech sector and VC facilitated the development of a successful and sustainable new sector of economic activity. However, the demand for funding dedicated to prevention, innovation and scaling up activities in Germany's welfare systems has not yet led to a similar response on the part of the financial industry.



The core idea behind social impact investing is to build a bridge between social impact and the deployment of capital. In doing so, the relationship between return, risk and impact is reconsidered. SII involves private capital that targets measurable positive social impact while at the same time offering social impact investors the opportunity of financial returns. For this to work, social impact investors must take an interest in both creating and verifying the social impact that occurs as a result of their investments.

At present, a widespread international debate over the precise conceptual formulation of SII is taking place. Various interpretations of the concept have arisen as a result of different understandings of the welfare state as well as existing opportunities for the use of private capital to achieve social

<sup>17</sup> Turnover in the social sector is calculated at €55 billion to €64 billion per year – Krimmer & Priemer (2013)

goals. A pragmatic definition of social impact investing has been developed by the Global Impact Investing Network (GIIN): “SII is investments made into companies, organisations, and funds with the intention to generate social and environmental impact alongside a financial return”.<sup>18</sup>

Consequently, four core characteristics of SII can be distinguished:

22

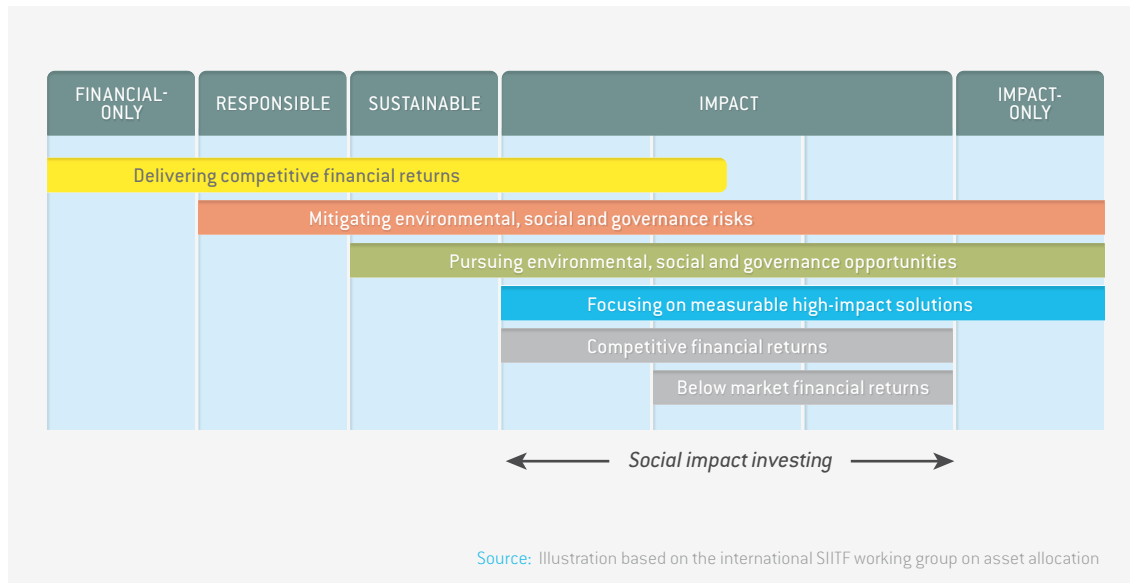
1. Intentionality: The intent of the investor to generate social and/or environmental impact through investments is an essential component of social impact investing.
2. Investment with return expectations: Social impact investments are expected to generate a financial return on capital and, at a minimum, a return of capital.
3. Range of return expectations and asset classes: Social impact investments generate returns that range from below market (sometimes called concessionary) to risk-adjusted market rates.
4. Impact measurement: A hallmark of social impact investing is the commitment of the investor to measure and report the social and environmental performance and progress of underlying investments. Impact measurement helps to ensure transparency and accountability, and is essential to informing the practice of social impact investing and building the field.<sup>19</sup>

In comparison with other investment approaches, SII is positioned in the middle of an “*impact continuum*”, between philanthropy on the one side and purely profit-driven investment on the other, as shown in Figure 4.

18 The GIIN (2010)

19 The GIIN (2010)

Fig. 4: A spectrum of capital



Philanthropy is a financial one-way-street because the transfer of money to the recipient is intentionally irrecoverable and the donor acquires no creditor or equity claims.<sup>20</sup> Furthermore, in the shape of *venture philanthropy*, philanthropic capital can serve as a catalyst for SII, if deployed in first-loss tranches of investments, for example. A related concept, which is also distinguishable from SII, is sustainable investing (also known as socially responsible investing, or SRI), which takes into account ecological, social and/or governance criteria as well as risk and return when making investment decisions.<sup>21</sup> In contrast to philanthropy, the goal of sustainable investing and other similar investment principles is typically aimed at inducing socially responsible behaviour and contributing to sustainable development (in the sense used by the World Business Council for Sustainable Development) on the part of for-profit enterprises.<sup>22</sup>

20 Oehri, Dreher & Schäfer (2010)

21 EUROSIF (2010)

22 A considerable share of SRI occurs in bonds issued by governments, supranational and multinational organisations, but this is beyond the scope of the current discussion.

### What is happening at present?

While SII, which links investment capital, explicit social goals and commitment to measuring impact, is in an early development stage in Germany, there is already considerable experience internationally, particularly in the United Kingdom, the United States, Israel, Australia and Canada. These countries are systematically developing markets in which supply and demand for impact-seeking capital converge. The United Kingdom is of particular interest with regard to the construction of such a market: In 2001, the Labour government appointed an interdisciplinary Taskforce to examine the way in which to garner the support of private backers for innovative and preventative measures in order to deal with the most intractable social problems that conventional methods had been unable to address effectively. This initiative was launched thanks to an awareness that, despite a period of economic prosperity and a corresponding feeling of optimism in the country, a segment of the population was being left behind. Based on the recommendations of the Taskforce, the first international social investment bank was founded, a number of investment intermediaries specialised in the social marketplace were developed, and tax breaks were offered to social impact investors, all within the last decade. These measures, supported by the UK government, are aimed at mobilising private financial resources to facilitate the development of solutions to profound social problems by providing greater resources, greater impact and more transparency. In particular, the development and implementation of the first “social impact bond” (SIB), a specialised “pay-for-success” social finance instrument, has attracted significant international attention (for more information on social impact bonds, see Spotlight 4, “*What are Social Impact Bonds?*”, page 36).

Inspired by the initial success of these measures, the employment of new financing instruments aimed at strengthening socially motivated organisations is also finding support at the EU level. The Social Business Initiative, an interdisciplinary initiative across three Directorates-General, will support the sector with cohesion-fund resources and by supplying fund-of-funds intermediaries with capital. Additionally, the EU Programme for Employment and Social Innovation supports the development of a market for social investment, placing a particular focus on new financing sources for socially motivated organisations. With the Social Impact Accelerator, the European Investment Fund (EIF), a subsidiary of the European Investment Bank (EIB), has created a fund of funds that has invested in existing SII intermediaries since 2013. In addition, investment vehicles can be certified on the basis of the Regulation on European Social Entrepreneurship Funds (EUSEF). In this way, European regulators intend to facilitate access to capital for socially motivated organisations. A EUSEF registration offers the particular advantage of a simplified Europe-wide distribution of fund shares with low investment amounts.



### Growing interest in Germany

In Germany, this type of direct social impact financing of social organisations is attracting growing interest. Specialised investment companies for social venture capital have existed for a number of years; KfW's financing programme for socially motivated organisations represents the first public-sector contribution to this area; while Ashoka, a support-network for socially motivated organisations, has founded the Financing Agency for Social Entrepreneurship (FASE) to provide effective and scalable socially motivated organisations with adequate financing. In the philanthropic field, the Association of German Foundations has established an expert group on "*mission investing*", which in turn has created a pilot fund for foundations, to become fully operational in 2014 (for more information on this pilot fund, see "*Mission-Related Investment (MRI) Pilot Fund for Education*" on page 45). The growing interest in sustainability among German investors and banks is further underscored by the steady rise in sustainable investing in Germany, which has grown by 9% between 2012 and 2013 to a total of €79.9 billion<sup>23</sup> while an annual "mood index" for sustainable investment improved by a full third in 2014.<sup>24</sup> Consequently, reports are beginning to refer to signs of a nascent market in Germany.<sup>25</sup>

25

While early indications are encouraging, it should be noted that despite the clear demand for capital the notion of private, impact-focused investment in the social sector is largely untested. The bridge between the relevant social sector actors and their financial market counterparts, both at the conceptual and implementation levels, has yet to be built. Non-profit organisations and the associations that represent them have reservations about SII as a financing approach, as they fear the replacement of public financing of statutory social services with private investment capital and a consequent erosion of reliable remuneration for their work. For this reason, these organisations regard a consensus on the precise role of SII within the existing financing system as being of particular importance.

23 Forum Nachhaltige Geldanlagen (2014)

24 Union Investment (2014)

25 Weber & Scheck (2012)

## SPOTLIGHT 3

### What are socially motivated organisations?

26

The contribution of socially motivated organisations in tackling social and ecological challenges has prompted growing interest in Germany in recent years. But what exactly are socially motivated organisations?

Socially motivated organisations are organisations whose self-defined and explicitly formulated goal is to create and preserve social value. This positive impact on society is achieved through the development of solutions that prevent or tackle problems related to social and economic exclusion, healthcare, the environment and local communities. To this end, socially motivated organisations in many ways operate similarly to private-sector businesses while deriving a substantial portion of their income from commercial activities as opposed to grants or donations. These commercial activities are not driven by profit-maximisation for shareholders or owners – instead, their main goal is to achieve positive social impact. This dominant aim cannot be ancillary or a by-product of a socially motivated organisation's operations. The primary use of the profits generated by commercial activities is the sustainable pursuit of social goals, not owner or investor pay-out. In socially motivated organisations with a “not for profit” orientation, the entire profit generated by commercial activities goes toward the sustainable pursuit of social goals and the accumulation of company assets necessary to attain these goals. For socially motivated organisations, profit does not form the incentive base for developing innovative solutions to societal challenges – instead, their rationale is grounded in addressing societal needs. This self-imposed social mission also affects relationships with beneficiaries, employees and other stakeholders, since many socially motivated organisations display a high degree of client orientation, participation and transparency. As such, socially motivated organisations are closely linked with civil society.

The number of socially motivated organisations with varying goals, operational forms, legal forms and types of financing is on the rise. However, not all socially motivated organisations are integrated into the public welfare system, in which the state, local authorities, insurance providers and non-enterprise civil-society actors (e.g. parents' associations, initiatives, self-help groups) cooperate and share responsibilities. Accordingly, being a socially motivated organisation is primarily a self-image, as there is no legal foundation for such organisations. In the context of SII as a new financing source, this situation creates a number of uncertainties both for such organisations and investors. To

name but two: What legal form is suitable for an organisation that pursues a social objective with entrepreneurial means? How would investments in this type of organisation be made?

When founding and scaling socially motivated organisations in Germany, the actors in charge must make a clear decision as to whether they want to create a for-profit or a non-profit organisation, the latter opening the possibility of attaining charitable status. Both forms offer certain advantages, but also limitations, as presented in the overview in Figure 5.

Should a socially motivated organisation opt for the for-profit legal form, it reserves the right to engage in commercial activities akin to traditional for-profit businesses while also having access to flexible means of financing. However, the social motivation of such organisations is not immediately apparent to customers and other stakeholders, in part because awareness of these new organisational models is limited. Additionally, the actual pursuit of the organisations' original social objective is dependent on the interests of its management and owners, meaning that a change of priorities can occur at any time.

Increasingly, intense competition for funding and donors as well as increasing demands for effectiveness and efficiency are also driving non-profit organisations towards adopting a progressively entrepreneurial stance. These social entrepreneurs, however, often perceive the legal framework as uncertain and limiting. Often-cited examples are the differentiation between “dedicated activity” (Zweckbetrieb) and “economic activity” (wirtschaftlicher Geschäftsbetrieb), the imperative for a prompt use of funds and rules regarding losses and dividend distributions. These regulations are perfectly sensible for purely charitable activities, as they create trust and can prevent organisations from developing along profit-orientated lines at the cost of clients or beneficiaries, which is particularly relevant for social service providers targeting disadvantaged and needy groups. For self-defined social purpose organisations, meanwhile, these rules can provide inherent constraints that limit competitiveness and the scaling-up of social impact. This can dissuade commercial and social impact investors from investing. It also puts constraints on the ability to create positive social impact for a broad portion of an economic sector that has already produced significant social innovation, and has thus demonstrated great economic potential.

Fig.5: For-profit and non-profit legal forms: the two worlds of social entrepreneurship in Germany

<b>FOR-PROFIT SOCIALLY MOTIVATED ORGANISATION</b>	<b>NON-PROFIT SOCIALLY MOTIVATED ORGANISATION</b>
<p><b>Description</b>                      Legal forms: GmbH, UG, AG (etc.)                      Commercial company</p>	<p><b>Description</b>                      Legal forms: gGmbH, gUG, gAG, e.V., foundation (etc.)                      Non-profit, charitable or religious objective                      Bylaws and management under § 52 Revenue Code</p>
<p><b>Advantages</b></p> <ul style="list-style-type: none"> <li>+ Free-market opportunities</li> <li>+ Flexible financing possibilities</li> </ul>	<p><b>Advantages</b></p> <ul style="list-style-type: none"> <li>+ Partly free of VAT, income, corporate tax</li> <li>+ Issuance of grant notifications</li> <li>+ Tax-free commercial activity to €35,000</li> <li>+ Strongly diversified income model</li> <li>+ Social objectives legally fixed</li> </ul>
<p><b>Limitations</b></p> <ul style="list-style-type: none"> <li>- No legal identification as socially motivated organisation (must convince customers, shareholders, etc.)</li> <li>- No tax-related incentives</li> <li>- Difficult to use non-profit financing/customers</li> <li>- Possible mission drift towards profit orientation (because social objective is not legally prescribed)</li> </ul>	<p><b>Limitations</b></p> <ul style="list-style-type: none"> <li>- Profit generation is never primary/co-equal goal</li> <li>- International activities have significant legal limitations</li> <li>- No dividends for investors</li> <li>- Unclear line between special-purpose enterprise and commercial business</li> <li>- Losses forbidden if commercial business</li> <li>- Principle of timely resource use</li> <li>- Exit strategies (M&amp;A, etc.) very limited</li> <li>- Risk of loss of non-profit status</li> </ul>
<ul style="list-style-type: none"> <li>• Choice of legal form can represent a choice of growth and scaling paths</li> <li>• No legal framework for recognition of socially motivated organisation</li> <li>• Complex hybrid structures secure competitiveness, facilitate scaling</li> </ul>	

Source: Bertelsmann Stiftung [2014a]

Due to the significant differences between non-profit and commercial enterprises, socially motivated organisations often find themselves in a quandary: they are too social to follow a for-profit organisation model, and too commercial to follow a non-profit organisation structure. Many of them choose to circumnavigate this situation by constructing a hybrid structure including both non-profit and commercial elements in order to take advantage of both domains and, most importantly, to be able to pursue their social mission effectively and competitively. An improvement that could avert this costly and often uncertain construction of hybrid structures is the introduction of a “mission lock” rule, in which the objectives of for-profit socially motivated organisations are fixed and visible to the public. A mission lock rule comprises a variety of advantages, including the following:

- It helps the organisations in question to fix their social mission and continuously use it for (re)orientation;
- It may preserve the founder’s legacy;

- It adds clarity in defining the terms and risks of investments;
- It increases investors’ confidence in the investment opportunity;
- It enhances trust among clients and/or beneficiaries;
- Conversely, it also permits the socially motivated organisation to set meaningful limitations on the social mission.

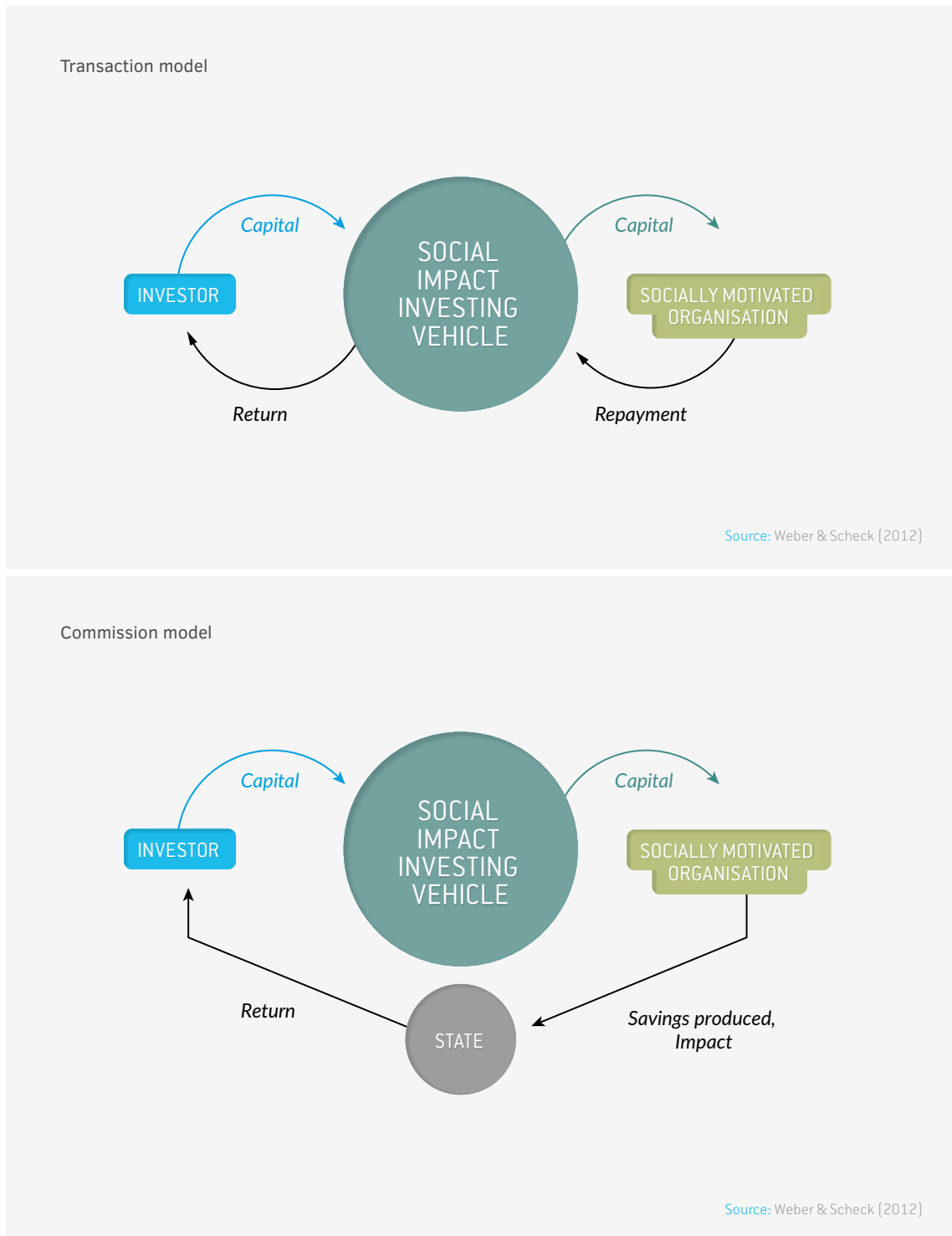
The design of mission lock mechanisms must take into account the interplay between the necessity of fixing the social mission and preserving entrepreneurial flexibility, thus allowing socially motivated organisations to react to both internal and external developments.<sup>26</sup>

26 Mission Alignment Working Group of the Social Impact Investment Taskforce established by the G8 (2014)

## Financing logic of SII instruments and examples of implementation

Fig. 6: Transaction model vs. commission model

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## Two sources of returns

There are two distinct modes of transferring capital between investors and investees in social impact investing: “*transaction models*” and “*commission models*”.

In the case of so-called ‘transaction models’ (see Figure 6), capital flows from the investor to the investee either directly or by way of an intermediary (e.g. a bank or a fund). The social investment vehicle forms the basis of a conventional investor-investee relationship, which may consist of either debt or equity financing. Financial returns gained through their economic activities are supplied directly to the investors by the investees. Consequently, transaction models are only viable for socially motivated organisations with business models that allow for the generation of financial surpluses.

When considering different modes of social impact investment, it is important to remember that a significant part of the services performed by socially motivated organisations in Germany are financed by social insurance agencies or public agencies. This financing generally takes place in one of two ways:

**Directly**, based on the service provider’s contractual integration into the three-way regulated social-system relationship: In this system, beneficiaries have a legal claim to benefits from the state, who either a) ensures service delivery by contractual obligation covering price and quality with the socially motivated organisations, or b) directly pays the service provider; or ;

**Indirectly**, where the state provides beneficiaries with a personal budget with which they can procure a range of social services within the marketplace.

The potential for refinancing, i.e. the ability of socially motivated organisations to repay their debts to investors, depends on several factors. If the socially motivated organisation is financed directly by social insurance agencies or public agencies, this potential hinges upon the financial leeway permitted in the service contract as well as the overall profitability of the socially motivated organisation. In the case of indirect financing, the potential for refinancing is contingent on the size of allotted personal budgets, and on the purchasing decisions of the beneficiaries.

By contrast, in the commission model, repayment to investors is not provided by the socially motivated organisation itself but by an interested third party, such as a public funding agency or a philanthropic organisation. As illustrated in Figure 6, transactions in the commission model consist of a three-way relationship between socially motivated organisations, investors and an additional actor. In this model, a socially motivated organisation obtains funding from the investors, who in turn receive their principal as well as their returns from interested third parties. This latter stage is generally based on contractual obligations (for example, dependent on the success of the social services performed). Such SII models are of particular interest to classic non-profit organisations, as it allows them to raise private investment capital without having to generate direct financial returns for the investors. In this model, repayment can be assumed by the public funding agencies that capture the beneficial financial effects of improved social services or activities. In return, they share cost savings gained from those social measures, thus enabling investors to achieve a return on their

original investment. In Spotlight 4, “*What are social impact bonds?*” (page 36), an instrument utilising the commission model is described in more detail.

30

At the systemic level of social service provision, potential for refinancing arises from the commission model’s consistently preventative orientation: new services or measures are organised so that their improved effectiveness leads to reduced expenditure. These savings may occur beyond the budget of the agency responsible for financing the services. For example, investments in child and youth support may prevent subsequent costs in the areas of education or penal system; investments by municipalities in support of the elderly can delay their transition to more costly forms of care funded by long-term care insurance carriers.

These circumstances, however, can also act as a barrier to the implementation of this form of the commission model because expenditure reductions often fail to be reflected in the budgets of those entities that originally financed the new services. For the systematic implementation of commission models to be successful, it must therefore be possible to utilise savings for the repayment of investors regardless of where they occur. In order to facilitate this development, dedicated “*outcome funds*” created specifically for this purpose and involving multiple public sector agencies are a possible solution.

## Examples of business models using the transaction model of SII

### EXAMPLE 1

#### VerbaVoice<sup>27</sup>

31

##### Social issue

Around 300,000 people in Germany (and around 40 million worldwide) have hearing problems which are serious enough that, in the absence of visual aids, they are excluded from many areas of our society. In many situations, the hearing-impaired have a legal entitlement to support services. Usually, sign-language or speech-to-text interpreters can be put at their personal service. This measure is costly and, due to the significant effort involved, often unfeasible.

##### Impact Model

VerbaVoice offers a unique system for the recognition and representation of speech in real time. Hearing-impaired individuals receive the speech as text with a high degree of accuracy and in near-real time through a mobile telephone or a device which can connect to the Internet. They can therefore follow work meetings or university lectures for example by reading along. The basis of VerbaVoice is a novel combination of automatic speech recognition, applications developed within the company and advanced mobile-network technology.

##### Social impact

Through the rapid, accurate and personalised transmission of conversations in text form, the everyday isolation of the hearing-impaired is reduced and their access to career opportunities is increased.

##### Innovation/prevention

The company addresses an existing market structured by the legally guaranteed claim of the hearing-impaired to receive suitable support. It replaces existing services with the use of an efficient and cost-saving system. As the first system of its kind, it is already recognised as a communication aid by the Bavarian Ministry of Social Affairs and Integration. The costs are borne by statutory funding agencies such as employment offices, integration agencies or municipalities.

##### Function of SII capital

SII capital was invested as social venture capital and helps to improve effectiveness, efficiency and innovation in the social sector.

## EXAMPLE 2

### Auticon<sup>28</sup>

#### Social issue

Nearly 1% of the world's population shows signs of autism. Because of their impairment in social interaction and communication, some people who are affected by autism have very few opportunities to pursue appealing training courses or career paths.

#### Impact Model

About 15% of people with Asperger's syndrome, an autism spectrum disorder, have above-average talents in the IT sector. Auticon, a socially motivated organisation, draws on the special capabilities of people with Asperger's by employing them for specific IT services, for instance, testing software. As a result of their consistently high ability to concentrate, the employees achieve significantly reduced error rates when performing repetitive tasks. The company's customers receive social coaching on communicating with Auticon employees.

#### Social impact

Only 5% to 10% of all people affected by autism are employed in the primary labour market. Auticon aims to facilitate the social inclusion of people with Asperger's syndrome, creating positions in the primary labour market and a suitable work environment for those with the disorder.

#### Innovation/prevention

In place of expensive and relatively ineffective integration measures, Auticon creates targeted jobs for people with a disability.

#### Function of SII capital

The investment here takes the form of "*patient capital*", which can be repaid from the company's profits over a flexible time horizon. Here too, investments target social innovation and focus on avoiding downstream social costs.



## EXAMPLE 3

### von Unruh & Team<sup>29</sup>

#### Social issue

In Germany, 6.5 million people are heavily in debt and the number of personal bankruptcies is increasing every year. A total of 900,000 people are currently involved in bankruptcy proceedings while insolvencies lead to economic losses of over €50 billion annually.

#### Impact Model

In the Federal Association of Bankrupt People and New Chances (*Bundesverband Menschen in Insolvenz und neue Chancen*, BV INSO), a non-profit association that organises self-help groups across Germany for individuals affected by bankruptcy and campaigns for a culture of second chances, it was recognised that there were no preventative counselling services for self-employed or freelance individuals or entrepreneurs facing an existentially threatening level of crisis. Since 2013, von Unruh & Team, a socially motivated organisation, has offered individual counselling and personal support for entrepreneurs. Numerous bankruptcies have already been prevented in this way.

#### Social impact

People affected by insolvency are still stigmatised as “*not creditworthy*” even years after their debts have been cleared. This has significant consequences for up to 600,000 people affected. Despite having a job and a regular income, they are often unable to obtain a bank account or rental contract and are barred from participating actively in the economic life of the country.

#### Innovation/prevention

von Unruh & Team is the first independent counselling firm that has set itself the goal of preventing bankruptcy among small and medium-sized companies. Another innovative feature is that each counsellor brings his or her own acquired business experience and crisis-management skills with them. As a socially motivated organisation, von Unruh & Team is managed from a market perspective. Nevertheless, its profits are used exclusively to invest in the further expansion of the company or are channelled to the regional BV INSO self-help groups or the associated Foundation for Financial Understanding (*Stiftung Finanzverstand*). These organisations support projects which provide training in financial literacy or which handle the training of counsellors. For customers who cannot afford counselling fees, a social fund and micro-credit programme is being established in collaboration with several foundations.

#### Function of SII capital

von Unruh & Team was successfully financed in December 2013 by two angel investors. For the start-up phase, capital in the form of a revenue-sharing model (mezzanine) was incorporated in order to optimise the social impact of the socially motivated organisation’s hybrid structure.

## EXAMPLE 4

### Local Allround Service Provision

(Dienstleistung und Ortsnahe Rundum Versorgung, DORV)<sup>30</sup>

34

#### Social issue

Societal development have created an increasing number of inadequately served residential areas in suburban and outlying village locations. Supermarkets, commercial areas and service providers are disappearing; real-estate and infrastructure are losing their value; and people are leaving the affected areas. Those remaining are often elderly and less-mobile citizens, who lack easy access to necessary supplies. In Germany, about 22 million people live in sparsely populated areas. A further 12 million people are forecast to leave these areas if the situation is not properly addressed.

#### Impact Model

Combined in one single location, DORV centres offer food, services, and social and medical care (e.g. groceries, meat products, nursing, postal services, etc.), as well as a social space where people can meet. In this regard, DORV offers a concept of multi-function needs provision that has successfully been implemented multiple times, in locations from which traditional providers have withdrawn. The operation of DORV centres themselves is carried out by independent contractors or local citizens' associations.

#### Social impact

DORV mobilises citizens to shape the future of their localities in order to secure a good quality of life for fellow residents. The definition of 'quality of life' employed in this case implies the possibility to live a whole lifetime in one's chosen social environment, securing jobs nearby and strengthening regional structures. In this regard, the key element aside from offers of products and services is to create a place for people to meet with one another. There are already 12 DORV centres in operation, benefiting over 10,000 citizens. The creation of a further 50 DORV centres is planned over the next five years.

#### Innovation/prevention

DORV embodies a unique concept of multi-functional local provisioning, and enables village and neighbourhood residents to secure a decent quality of life while breaking the vicious and widespread cycle of outward migration and elimination of local amenities. Since the founding of the first DORV centre, the demand from municipalities to implement the DORV model in other regions has grown steadily. Since its formation, DORV has received approximately 100 requests for consultations to construct similar centres across Germany, of which 40 have received active support to date.

#### Function of SII capital

As a socially motivated organisation, DORV is guided by market principles. It generates income by providing consulting services to municipalities for the construction of new DORV centres and through licensing fees and training programmes. Growth capital to successfully expand the scale on which DORV model was implemented came from a foundation and a social angel investor. Future profits will be used for the further expansion of the business or to support the non-profit affiliate.

## EXAMPLE 5

### Discovering Hands<sup>31</sup>

#### Social issue

In Germany, breast cancer is the most common type of cancer suffered by women. The probability of a fatal outcome to the disease is strongly dependent on the time of diagnosis. The cost of a preventative mammography is covered by health-insurance companies only for women between 50 and 69 years of age. For women under 50, palpation, a manual physical examination conducted purely through touch, is usually all that is available. At the same time, there are about 1.2 million people in Germany whose vision is less than 30% of normal strength, many of whom are not gainfully employed despite being of working age. It is estimated that the unemployment rate among the visually impaired is about 10%, and that women with visual impairments are particularly disadvantaged with regards to employment. A lack of appropriate facilities and adaptive measures in the work environment as well as prejudice against the capabilities of visually impaired people explains their relatively low rate of labour-market inclusion.

#### Impact Model

The gynaecological breast palpation, which represents the only early breast-cancer screening measure for women between 30 and 50, is not performed under standardised and validated procedures, and often takes place under great time pressures. Discovering Hands trains blind women to perform these breast-cancer screenings; in this way, the company fills this screening gap while at the same time creating a meaningful activity for disabled people that has clear advantages for patients: blind people have a demonstrably superior sense of touch, which expresses itself, for example, in the ability to read Braille. Palpation by these screeners is based on a specially developed, standardised and quality-assured screening model.

#### Social impact

Discovering Hands is based on a standardised palpation screening process that optimises the early diagnosis of breast cancer. Blind women receive employment for which they are eligible as a result of their special talent. To date, more than 10,000 patients have been screened; in the next five years, more than 38,000 will be screened in Germany.

#### Innovation/prevention

A noticeable improvement in breast cancer prognoses has resulted from improvements in early detection. Blind or visually impaired women who qualify to become screeners have successfully translated their "inability" into a talent. Independently carrying out an activity with a high degree of responsibility, they serve a useful and positively perceived role in the health care system. Their effort leads directly to better screening diagnoses; moreover, by improving women patients' motivation to take advantage of all prevention services, it indirectly leads to a better detection rate for early carcinomas, and thus to a reduction in treatment and follow-up costs. Even if the screener is employed only in the context of early breast-cancer detection, Discovering Hands stands for a significantly broader vision, which is to use blind and partially sighted people's highly developed sense of touch in all medical fields in which the diagnostic process involves the sense of touch. Particularly in the international market, there is a need in the areas of thyroid, prostate, testicular, glaucoma and lymphatic system diagnostics, for example. Also noteworthy is the fact that, especially in countries with a relatively low availability of instrument-based screening, the number of blind and visually impaired people is often particularly high.

#### Function of SII capital

For its penetration of the German market and the international expansion of its business model, social impact investors provided the necessary growth capital for Discovering Hands.

## SPOTLIGHT 4

### What are Social Impact Bonds?

36

Social Impact Bonds (SIBs) are essentially instruments for cross-sector cooperation. The parties associated with a SIB include one or more social service providers, social impact investors and public agencies. SIBs can help to achieve three goals:

- **The impact oriented use of public funds**

SIBs enable the creation of a link between funding streams and social impact goals which far surpasses the more widely used outcome incentive systems (e.g. premium models).

- **Investments in preventative measures**

SIBs allow the state to focus mainly on preventative measures, thus averting any higher downstream costs associated with social issues.

- **Promotion of social innovation**

SIBs facilitate the financing of projects that have the potential to have a great impact but that have not yet reached a large scale.

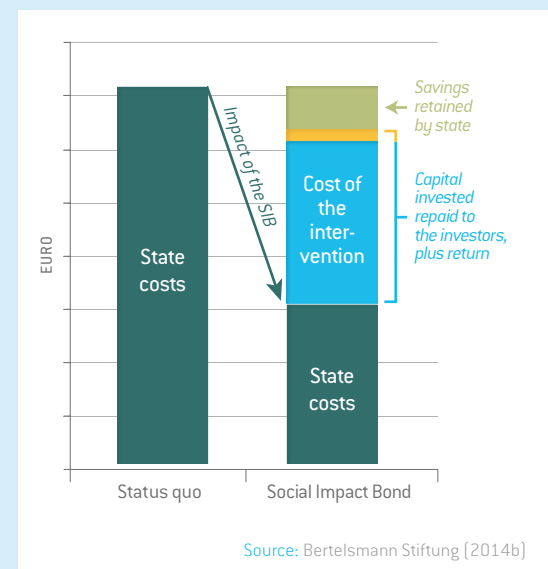
Cooperation between the parties is governed by a set of contracts. In these documents, the specific financing mechanisms, the distribution of risks and the desired impacts are explicitly articulated, and the parties' obligations are agreed upon:

1. The social service provider pledges to aim to a proven intervention that will achieve measurable social impact. For example, this could be close support on-hand for long-term unemployed youth, increasing the probability that they can be integrated into the labour market in the long term.
2. The intervention is financed by private investment capital. If the intervention achieves its desired social impact, the investors are repaid their principal along with a return that is calculated in accordance with the rate of achievement, that is to say, in terms of the impact of the social measures.

3. The return paid in this case does not come directly from the investee (the social service provider) but is instead paid by the state if the financed intervention proves to be effective and generates public savings (see Figure 7). One example might be the successful integration of the long-term unemployed into the labour market which would significantly reduce state expenditure on unemployment benefits.

The use of SIBs lends itself to situations where preventative, scalable measures for a clear target group are present, and where a problem is of great importance to the public sector. The SIB model enables the public sector to intensify its impact goals to a considerable degree instead of financing the "usual measures". Meanwhile, the associated risk is borne by the social impact investors, who in turn seek to bring about a direct, visible and positive change in their region.

Fig. 7: Impact model of a SIB



Internationally, various SIBs have been implemented or are in the planning phase:<sup>32</sup>

Country	SIB thematic area
Australia	Child and youth services
Australia	Early childhood services
Australia	Resocialisation of criminal offenders
United Kingdom	Resocialisation of criminal offenders
United Kingdom	Long-term care provision ×2
United Kingdom	Labour-market integration ×10
United Kingdom	Homelessness
United Kingdom	Care for the elderly
United Kingdom	Adoption
India	Education
Israel	Labour-market integration ×2
Israel	Resocialisation of criminal offenders
Columbia	Youth pregnancy
Mozambique	Malaria
Pakistan	Primary school education
South Africa	Criminal justice reform
Swaziland	HIV and TV prevention
Uganda	Combating sleeping sickness
Uganda	Secondary education
USA	Resocialisation of criminal offenders ×2
USA	Labour-market integration ×2
USA	Homelessness
USA	Early childhood services
USA	Asthma
USA	Care for newborn babies

## Examples of business models using the commission model of SII

### EXAMPLE 6

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#### Eleven Augsburg Model Project (Social Impact Bond)<sup>33</sup>

##### Social issue

The Eleven Augsburg pilot project focuses on disadvantaged, unemployed young people who are in a transitional stage between receiving vocational training support and youth services. These young people tend to be beyond the reach of the Federal Employment Agency, job centres or youth services agencies. The young people in the target group do not appear in statistics and are thus barely visible. Their chances of finding training, further education or employment decrease significantly over time, which subsequently results in significant costs for the public sector.

##### Impact Model

Since previously funded measures had been unable to reach these young people, the situation presented a promising opportunity for a social impact bond pilot project. The basis for Eleven Augsburg is an agreement between Juvat gGmbH, a subsidiary of the Benckiser Stiftung Zukunft, and the Bavarian State Ministry of Labour and Social Affairs, Family and Integration. It was stipulated that during the course of the project, a previously defined number of youths would be brought into vocational training or work and would be retained for more than nine months. The clearly defined terms of the desired objectives as well as the precise delineation of the target group ensure unambiguous measurement of the project's progress. Eleven Augsburg's initial financing was provided by four non-profit organisations: the BMW Stiftung Herbert Quandt, the BHF-BANK Stiftung, the BonVenture gGmbH and BMW's Eberhard von Kuenheim Stiftung. The four project partners entrusted with the task of implementing the SIB – Ausbildungsmanagement Augsburg; Kinder-, Jugend und Familienhilfe Hochzoll; apeiros e.V.; and Joblinge gAG München – combined youth-service programme modules, which were specific to the target group, vocational training support and career orientation. The decisive factor here was the customisation of the modules, since the target group was no longer being reached by the regular measures. After passing through an intensive support programme, initially within comparatively safe project spaces and then inside companies providing apprenticeships, participants are placed on vocational training programmes or in employment, with follow-up support included.

##### Social impact

Within the framework of the SIB, disadvantaged young people who had not been reached by existing programmes for an extended period of time are integrated into training programmes or work. Because the payment of the agreed bonus by the public sector is effected only upon the achievement of the predetermined target criteria, the evaluation of the SIB takes on a decisive importance: the pre-arranged target premiums are paid to the financing entity only after a determination of success is made by an independent external evaluator. An additional process of evaluation performed by the University of Hamburg offers important parallel insights into the mechanisms of pay-for-success approaches.

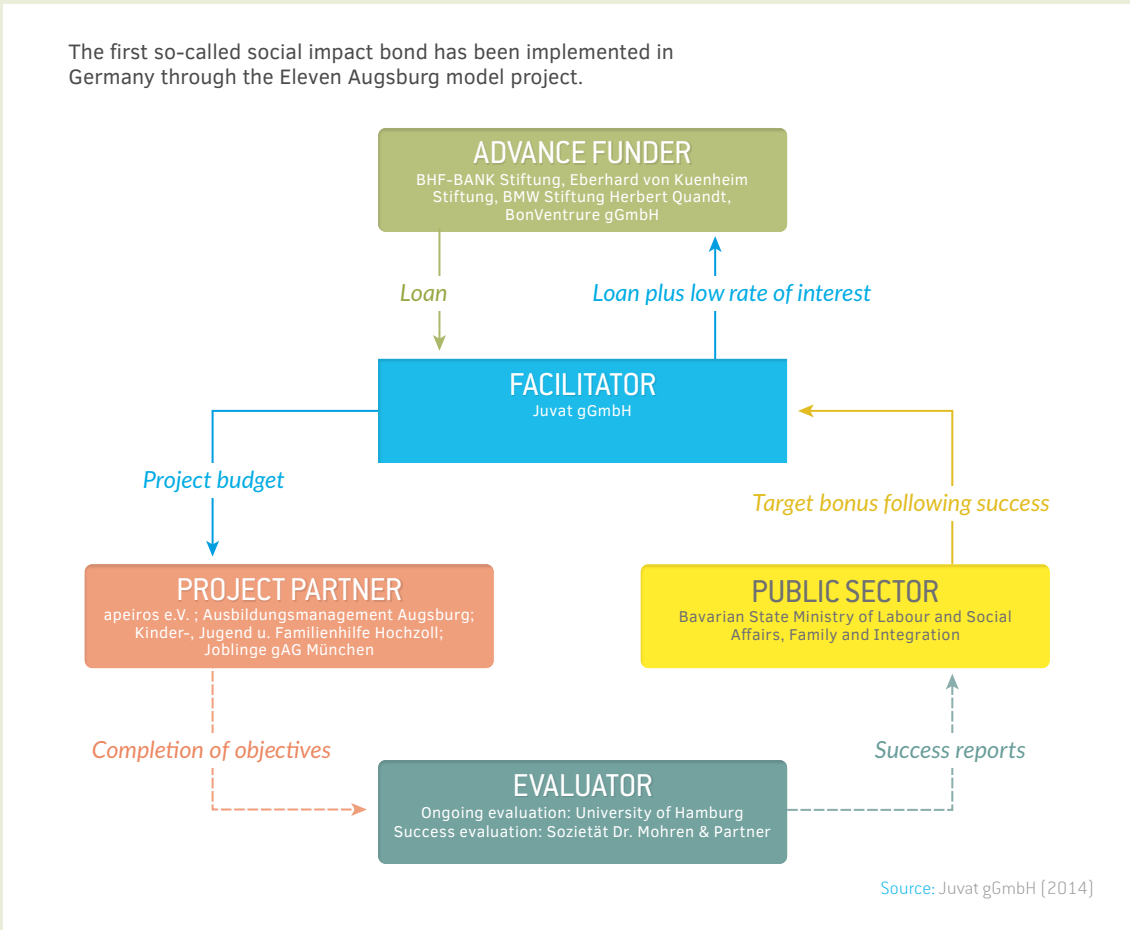
##### Innovation/prevention

With its limited resources, the public sector faces steadily growing social challenges. At the same time, effective preventative work saves the state considerable downstream costs in the medium and long term. Social impact bonds like Eleven Augsburg are able to link appropriate projects with impact-seeking capital, of which there is a considerable amount available. In addition, the SIB framework raises levels of motivation on the part of the different project partners. With the assumption of risk by an entity that funds the project in advance, the work is reliably guaranteed over the entire lifespan of the project, whose participants are therefore free to devote their focus to substantive work. The non-bureaucratic construction of the SIB pilot project also gives the project partners the opportunity to enter into cooperation without constraints, which in turn increases the effectiveness and sustainability of the actions taken.

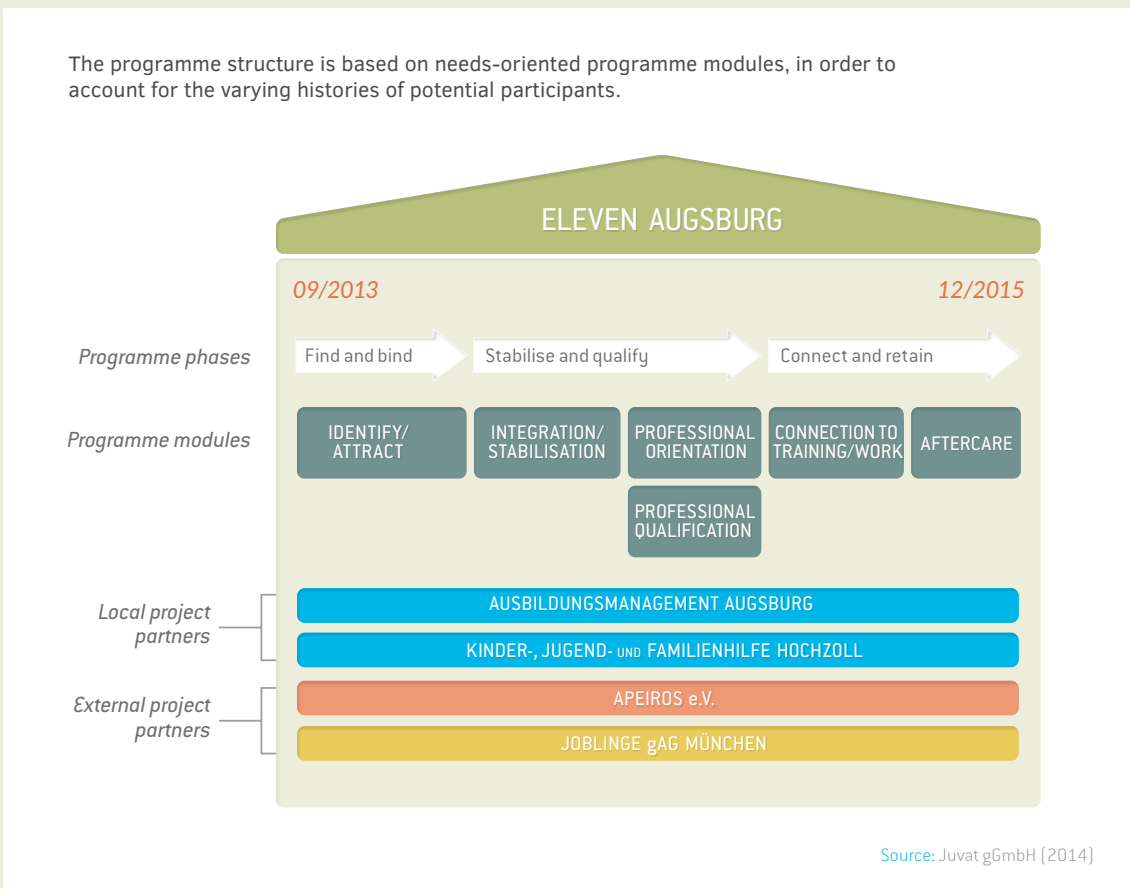
##### Function of SII capital

The SII capital provides funding for a social service with a preventative character in advance and enables the social service provider to demonstrate that the goals formulated by the public sector can be met effectively. If successful, the bonus agreed in the contract is disbursed and the entity providing advance funding is repaid the amount they originally invested along with a modest rate of interest.

Fig. 8: Eleven Augsburg Project Structure:



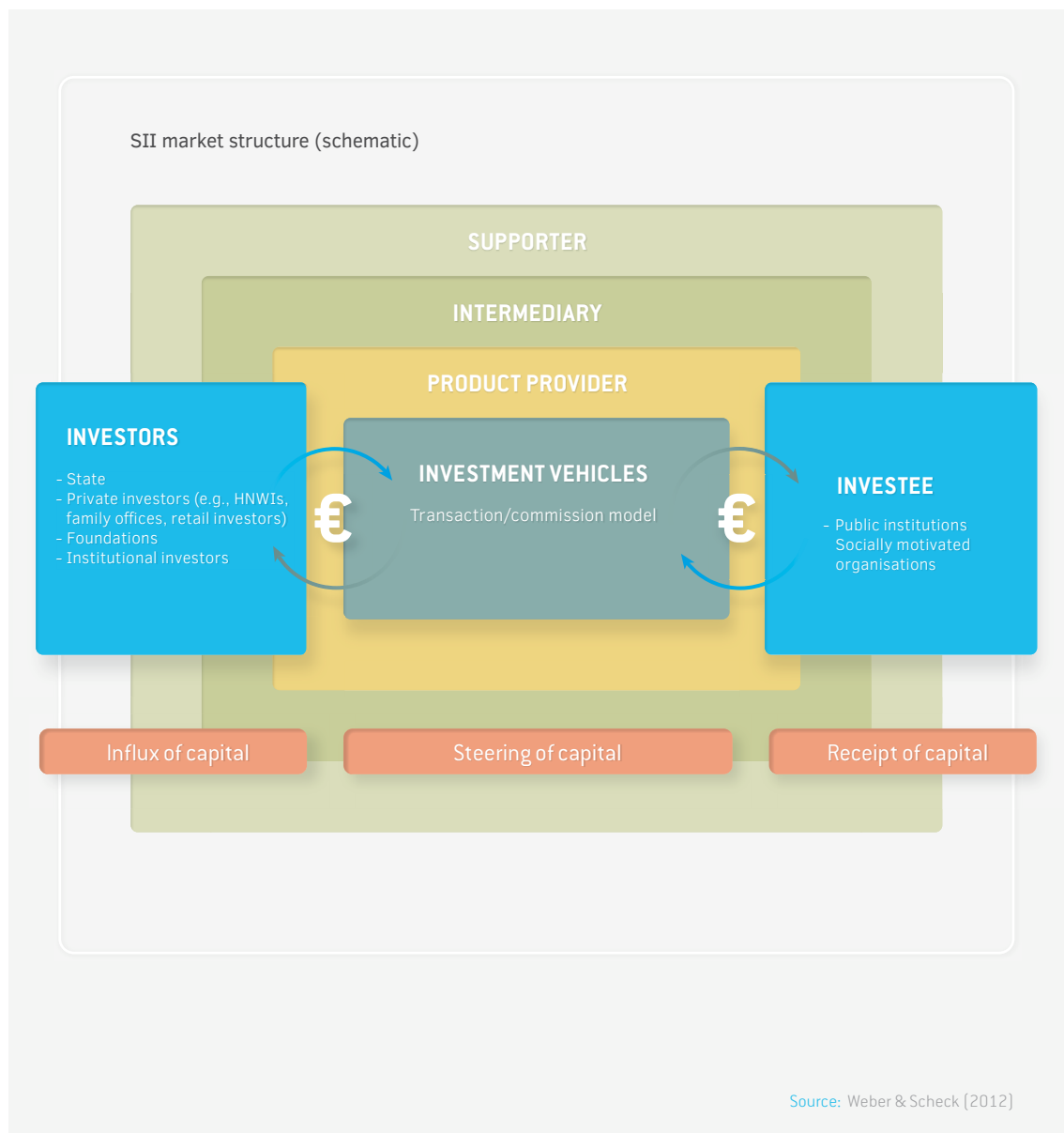
The programme structure is based on needs-oriented programme modules, in order to account for the varying histories of potential participants.



## The existing SII-ecosystem in Germany

Even though there are few examples of social impact investments in Germany, the ones which are already in place demonstrate that it is possible to produce a positive social impact through innovative and entrepreneurial approaches supported by private investment capital. In this regard, the actors involved on both the investor and investee sides are delivering important pioneering work. Through their capacity for innovation and readiness to take on risk, they are taking the first steps towards the construction of an effective SII market in Germany. Figure 9 illustrates the processes underlying such a market.

Fig. 9: SII market structure (schematic)





### Intermediaries as catalysts of social impact through SII

To date, Germany's SII activity has largely consisted of individual examples driven by specialist intermediaries that match supply with demand. These providers of social impact investment products collect funds from investors and pass them on to socially motivated organisations as guarantees, equity capital, mezzanine capital and loans. In addition to financing, they offer their investees support by imparting management know-how and contacts who can support socially motivated organisations in their growth. The same type of intermediaries that finance commercial enterprises and are active within traditional financial markets therefore also exist within the SII sphere. In the German SII market, there are two leading social venture capital funds, BonVenture and the Social Venture Fund. In addition, Tengelmann Social Ventures has also been active since 2013. Taken together, they manage approximately €40 million in assets, and make equity capital, mezzanine capital and debt capital available to socially motivated organisations in amounts ranging from €200,000 to €1.5 million. With minimum capital contributions of €100,000 to €500,000 for these funds, it is primarily high net worth individuals (HNWI), (non-German) foundations and institutional investors that provide the capital needed. Until now, these funds have analysed more than 3,000 investment opportunities, with 29 socially motivated organisations in Germany receiving funding, of which nine exits have been accomplished.<sup>34</sup> In addition, the state-owned Kreditanstalt für Wiederaufbau (KfW) has itself become an intermediary and social impact investor. Through a support programme developed jointly with the Federal Ministry of Family Affairs, KfW has provided up to €200,000 per individual case to socially motivated organisations since the beginning of 2012. These resources are treated as matching funds, which KfW places as a co-investment along with other investors.

41

While the intermediaries mentioned above act as investors, intermediaries such as the Financing Agency for Social Entrepreneurship (FASE) support socially motivated organisations in raising growth capital (primarily with regard to transaction structuring and investor dialogue). In this way, innovative hybrid financing approaches can be developed and tested. FASE forms coalitions of financiers that are drawn from a whole spectrum of private investors, family offices, social venture capital funds, banks and the public sector. To date, four funding projects handling between €100,000 and €500,000 have been executed.

Another important function of specialised intermediaries is that of advising socially motivated organisations during their founding stage. At present, there are a number of initiatives providing start-up support for socially motivated organisations. This includes, for example, that of the Social Impact gGmbH, offered with support from SAP and with funding provided by the Federal Ministry of Family Affairs, Senior Citizens, Women and Youth (BMFSFJ). Since autumn 2011, more than 500 social start-up teams have applied to be a part of this programme. The Impact Hub Network has pursued a similar objective on an international scale and is now represented in Germany, with locations in Berlin and Munich.

In addition to those intermediaries that specialise primarily in advising and supporting investees, there are also intermediaries that are concerned with providing consulting services to investors or with the development of new structured financing vehicles. The Munich-based enterprise Impact in Motion advises both private and institutional investors (e.g. specialised funds) with regard to investment opportunities in the area of SII. It also supports wealth managers and both private and public sector organisations in their conception, development and implementation of social impact financing vehicles (e.g. social impact bonds), and contributes to the transparency and further development of the SII market through systematic market analysis.

Other actors with similar objectives have long operated within the extended environment of these intermediaries. For instance, alternative banks (e.g. GLS Bank) and church banks (e.g. the Evangelische Bank eG or the Bank für Kirche und Caritas eG) provide financing for micro-enterprise projects using self-initiated funds (e.g. microfinance funds), primarily in developing and emerging countries, with the aim of reducing poverty. Traditional banks also offer investment products related to SII, in the form of savings certificates, for example. Above all, credit unions and credit cooperatives (Volks- und Raiffeisenbanken) offer shares of companies involved in the environmental sector to a broad circle of investors. Moreover, savings banks, credit unions and credit cooperatives play a significant direct or indirect financing role through their own foundations in the area of long-term and geriatric care. At the state level, there are several financing institutions (e.g. L-Bank in Baden-Wuerttemberg) which, among other functions, support social organisations during their founding stage and protect investors from default risks through the provision of guarantees. In short, targeted societal development can also be supported using credit-based financing. With innovative initiatives, this kind of credit provision can be combined with lending and grant-making associations, community groups, or even be implemented on a cost-recovery basis (instead of using interest-based credit).

### **Who is already investing?**

The capital invested in the examples mentioned above is primarily philanthropic and socially motivated – the investors thus fall into the category of impact-first investors. In Germany, as in other countries, social impact investors are often people with a background in business who now act as angel investors and support “their” socially motivated organisations with business know-how and access to networks. This is true of VerbaVoice and Auticon, both of which received capital and immaterial support services from their main investors. Many of the social impact investors active in Germany are also members of networks such as Toniic or FASE, or of the Ashoka Support Network. In Germany, this form of investment has been made primarily by private high net worth individuals so far, though other investor groups such as foundations are now showing a growing interest in SII.

### Who are the future investors?

In order for SII to establish itself over the middle and long term as an additional funding option for socially motivated organisations in Germany, and thus make a significant contribution to the tackling of existing and future demographic and social challenges, a significantly larger volume of private investment capital must be mobilised for social purposes in the coming years. This includes types of investors who – unlike primarily philanthropically-motivated investors – cannot accept lower returns or higher risk in favour of social impact. There are already investors whose investment behaviour demonstrates an affinity for SII but whose potential involvement has yet to be fully realised.

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How do various potential investor groups respond to SII; and to what extent is there opportunity to expand the current core of social impact investors to include additional investor groups? What follows below is an overview of the investment behaviour and motivations of various investor groups involved with SII, and a discussion of several areas of untapped potential.

### Foundations in line with their missions

Foundation activity in the SII field is referred to as mission-related investing (MRI). In this model, a foundation's assets are invested in accordance with the social or ecological goals of the operational and other grant-making activities. According to the opinion of the Association of German Foundations, this two-fold objective is viable both under foundation-law and tax-law frameworks.<sup>35</sup> Yet foundations have only played a limited role as active social impact investors so far. As revealed in an ongoing survey of selected German investor circles by the University of Stuttgart,<sup>36</sup> it has become clear that foundations are only active to a very limited level in SII, as they prefer to directly finance specific projects that are aligned with their own missions instead of investing in SII financial products (e.g. investment funds). There appears to be a requirement that SII have market-level risk-return profiles and that social impact should not come at the expense of financial yields. Below market rate returns would in this regard be accepted only insofar as they are temporary and do not erode the foundation's ability to maintain its endowment. Key areas preferred by foundations for their SII activities include housing, climate protection, social entrepreneurship and, to a lesser extent support and care for the elderly. So far, there has been comparatively little experience of investments in the areas of education or further education, professional skills development or children and youth services. In terms of providing services for children and young people through foundations, there is a lack of clarity among foundations as to whether a profitable business model can be established that would generate the levels of return they require. As charitable law and specific regulations pertaining to foundations are governed on a state by state basis in Germany, considerable uncertainties about SII persist among German foundations as well as regulatory and oversight agencies.

Against this background, the Association of German Foundations has been running a Mission Investing Expert Group since 2013, led by the Eberhard von Kuenheim Stiftung. The group comprises 15 member foundations and strives to examine the conditions for investment in enterprises

35 Schneeweiß & Weber (2012)

36 The survey is currently being conducted by the finance chair at the University of Stuttgart on behalf of the Bertelsmann Stiftung.

and organisations with a proven social impact. In 2014, the expert group set up a mission-related investing (MRI) pilot fund with a focus on education; this was also the first pan-European MRI project registered under the recently adopted European Social Entrepreneurship Funds (EUSEF) regulation. Further innovative impetus for the German SII market can thus be expected from this group.

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Since most SIIs are regarded as so-called 'alternative investments' due to their above-average risk levels, it is most likely only relatively large and accordingly well-capitalised foundations with an asset base of more than €1 million that will be in a position to assume such risks and the additional costs associated with setting and monitoring impact goals. However, in addition to their potential investor role, foundations can take on a key development function; for example, by assuming risk through investing *first-loss* capital drawn from operational budgets rather than from the foundation's endowment, foundations can play an essential role in required development of the market infrastructure to enable others to enter this field.

## EXAMPLE 7

### Mission-Related Investment (MRI) Pilot Fund for Education, established by the Mission Investing Expert Group<sup>37</sup>

The MRI Education Pilot Fund was launched to enable charitable foundations under German law to invest a part or the entirety of their endowments in accordance with their mission, thus maximising their social impact. The projects or enterprises receiving investment must be socially motivated organisations with a focus on solving problems in the education sector in German-speaking countries.

#### Social Problem

Foundations typically fulfil their mission by distributing the income derived from the investment of their endowment assets. However, most investments made by foundations are not directly consistent with their objectives for the following reasons:

- Foundations typically separate “*mission-related*” and “*asset management*” functions, particularly if they use external asset managers.
- Finding appropriate individual projects or investments that are aligned with their mission proves to be difficult.
- There is a lack of general awareness that investments can multiply social impact..
- Foundations often lack the necessary expertise to deal with financial instruments.

#### Impact Model

The tool being used to address this problem is essentially conceived as a classic (private-equity) investment fund. As a pioneer project, the MRI Education Pilot Fund has been given initial funding of a relatively modest amount: €500,000 to €1 million. It has a project duration of just four to six years. The pilot fund is intended to serve as a model for future funds with other objectives and goals.

The fund's cost structure is set up so as to facilitate support services for the socially motivated organisations that receive its funds while retaining expectations for financial returns of at least 2% after costs. As an investment fund, the MRI pilot fund generates financial proceeds for investors only if the resources provided to the socially motivated organisations are also counted as revenues.

#### Social impact

Through the MRI pilot fund, more resources are made available for selected and tested SII projects. Programmes that wish to be financed must achieve certain outcomes: the educational level achieved by the target group should rise significantly, and the actions and behaviour of participating individuals and institutions must change in a sustainable manner. The MRI pilot fund is intended to serve as a model for similar funds with other thematic foci. Enterprises seeking funding must submit a fully developed business case and a tested concept. Because foundations prefer low-risk investments, funds will be invested in the growth and development stages of socially motivated organisations, and will not be used as seed capital.

### Wealthy individuals are seeking new forms of engagement

By transferring significant assets to foundations, some German high net worth individuals (HNWIs) have already indirectly invested in SII. Although HNWIs are internationally regarded as having a particular affinity for sustainable investments,<sup>38</sup> little is known with regard to the actual scale of such investments. In addition, little is known about this group's incentives to invest in SII, or about its motives and attitudes regarding the return-impact relationship. Nevertheless, wealthy investors in Germany appear to present great potential for the SII sector. Quite a few HNWIs are likely to be willing to place additional investment funds in various forms of SII investments, such as private equity or venture capital funds, or other similar vehicles (closed-end funds or special funds). Willingness to invest is likely to depend on specific criteria such as project scale, the size of club deals, special incentives for engagement in certain social sectors and requirements with regard to the return-impact relationship. This could well complement the philanthropic activities of HNWIs.

Initial findings from the survey mentioned above reveal that the awareness of German HNWIs of SII often stems from their philanthropic engagements. SII is often regarded by this group as being in competition with alternative forms of "giving". Consequently, below market rate yields are widely accepted. The difference between this rate of return and a market rate of return is interpreted as a donation. In addition, HNWIs rarely have concrete expectations of their desired impact or return when making an investment decision in SII, although a regional focus for SII-financed projects can be clearly distinguished. However, in comparison to other investments, SII still plays a minor role overall for German HNWIs. This is in part because SII is regarded as extremely complex and non-transparent, and there is currently no specially targeted advisory service for this field. The process by which HNWIs select SII as their chosen method for philanthropic investments is therefore, to a large extent, spontaneous and unstructured. When making investment decisions, investor-specific or personal attitudes and experiences (e.g. business activities) are often of crucial importance.

### Retail investors as the investors of the future?

Personal identification with capital investment and the opportunity to be able to observe their effects at a local level makes SII appealing to retail investors too. As it has already been demonstrated in the field of renewable energy, private households in the aggregate show a high degree of readiness for objective-driven investments, and overall, they have invested a significant sum in standardised SII (e.g. climate savings bonds). However, such investment products must offer reliable returns, risk levels suitable to the individual investor and a high degree of liquidity. They must focus on social themes that the average household can comprehend and underlying projects should be located close to the investor (e.g. funding a residential facility for the elderly through the purchase of a cooperative share). As a mode of equity capital participation, cooperatives seem particularly suitable for this investor group, as they grant special participation rights and are well-established in the social sector. Citizen-focused participatory models implemented by savings banks are oriented in a similar direction. For some time, some savings banks, credit unions and credit cooperatives have offered special savings products that actively support civic engagement through investment, such as the city of Freiburg's

Cathedral Savings Bond which supported the renovation of the Freiburg cathedral or BW Bank's Future-Focused Savings Certificate (ZukunftsSparbrief), which, among other goals, provides funding for social organisations.

So-called 'crowdfunding' offers another example of a participation model. Crowdfunding is a new form of financing based on the idea that funding for a specific project can be secured through the financial backing of a large number of small investors who are reached by means of an internet campaign. Possible financing forms include equity investment, loans, preselling or even donations. In the context of the Social Impact Start-Up Programme, for example, social start-ups were given support in the development of crowdfunding campaigns. Thus far, seven projects, including five from the Social Impact Finance webpage, have been placed on the market. The total volume of crowd-derived funding came to approximately €500,000.

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The inclusion of retail investors in SII has several advantages: among these are the diversification and democratisation of the investor base, an improved balance between economic and social impacts at the local level, a more long-term orientation for the investment projects and the nurturing of local engagement.

### **Pension and life insurance funds: the most difficult hurdle**

Pension and life insurance funds are already considered to be two of the most important sources for socially responsible investments in a wider sense. However, the strict regulation faced by these entities (defined in, among others, the Insurance Supervision Law, the Regulation on the Investment of Insurance Companies' Tied Assets, and R4/2011) represents a great challenge with regard to involvement in SII. The new Solvency II regulation for insurance companies, which as of 2016 will impose new capital adequacy requirements of up to 59% for risk-carrying investments and is a category that will include several forms of SII, is an additional obstacle. However, SII in the form of real estate could represent very promising investment opportunities. Under the current regulations for pension funds, investments of up to 25% of pension assets in real estate are allowed either directly or indirectly (e.g. through REITs or real-estate funds). Since many social services such as residential facilities for the elderly or disabled are linked to real estate, pension funds are often already represented here as investors. This seems to be the obvious means by which pension funds can provide capital for the purpose of social impact investments.





## CHAPTER III.

### Analysis and communication of impact

Demonstrating social impact lies at the heart of social impact investing. Within socially motivated organisations impact analysis is used as an internal learning and steering instrument, while externally, it serves to mobilise social impact investment capital. For investors, impact analysis enables comparisons in terms of social impact and expected levels of return between different investment opportunities. Beneficiaries' concerns are reflected to a higher degree in the impact goals of socially motivated organisations. At the systemic level, impact analysis may facilitate faster scaling as well as the accumulation of knowledge and skills. Impact analysis thus aspires to improve both transparency and opportunities for accountability for all stakeholders. In short, employed properly, impact analysis can benefit all actors involved.



#### What is impact analysis?

Quantifiable findings resulting from impact analyses are of considerable advantage in comparing the impact achieved through different organisations, measures and approaches, and thus serve as an aid when making social impact investment decisions. However, the methodological discussion in this area is ongoing. Experts have repeatedly indicated it is necessary to include qualitative criteria when evaluating, describing and analysing the impact of social work.<sup>39</sup> Meanwhile the level of acceptance and organisation-specific learning cultures contribute to the heterogeneity of approaches.

In order to attempt to do justice to the diversity of actors and approaches, the authors of this report here chose to offer a minimal definition of impact analysis:

*"Impact analysis examines the impact of social work interventions in relation to the achievement of the overall objective."*<sup>40</sup>

This definition enables priorities to be set, objectives for outcomes and impact to be incorporated, and impact to be measured.

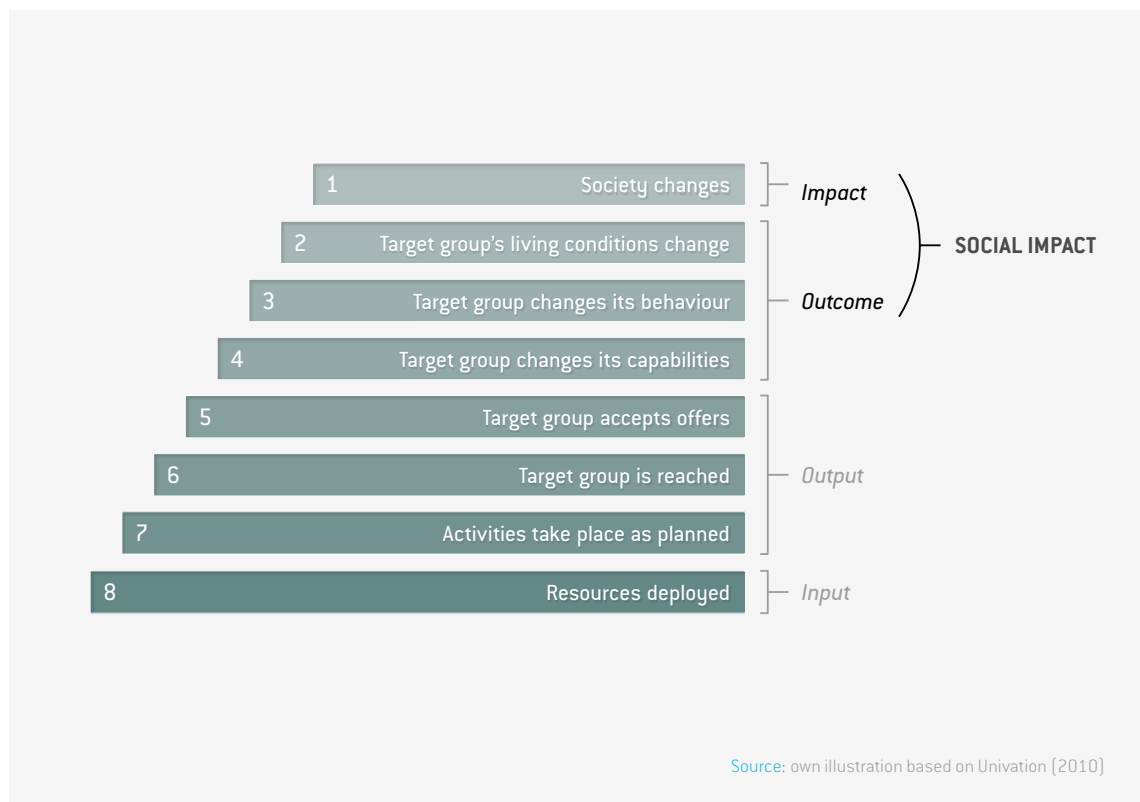
39 Miethe, Eppler & Schneider (2011)

40 Based on Neubert (2005)

### Impact analysis in transition

Over the last decade, a new debate on impact heavily influenced by economic concepts has reached virtually all areas of the social sector.<sup>41</sup> A new generation of social impact investors has asserted that it wants to generate a “social return”, the verification of which can only be carried out through impact analysis. In describing these causal relationships, a certain understanding of impact logic has been adopted, namely a distinction between input (the resources used), output (the immediate results), outcome (the change achieved in the target group), and impact (changes achieved at the general societal level).<sup>42</sup>

Fig. 10: Impact steps in social work



41 Rauschner, Schober & Milner (2012) and Wilke (2010)

42 Depending on the project, 'outcome' may also refer to the intermediary or organisation receiving counselling, and 'impact' may resonate at the target-group level.

A variety of social, demographic and economic changes are driving the current discussion of impact analysis in Germany's social sector. As explained in the introductory chapter, fiscal-policy challenges are making it more difficult to finance welfare services and are producing conditions in which welfare service providers must increasingly substantiate the impact, quality and costs of the services they offer. Furthermore, the introduction of new public management models, as well as increased competition within the context of EU law is causing additional pressure on actors in the social sector. In addition, social service providers are forced to differentiate themselves from their competitors due to the increased internationalisation of sub-markets in the area of personal services. Finally, dramatic demographic changes in Germany force funders of social services to seek particularly effective approaches that can meet social challenges adequately.<sup>43</sup>

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Despite these developments, many social organisations and socially motivated enterprises are just beginning to perform consistent impact analyses.<sup>44</sup> Empirical surveys show that only a small share of this group is currently in a position to record its impact and utilise the results as a steering instrument.<sup>45</sup> The requirements of funding providers with regard to service-provider quality control are still primarily oriented towards the resources used and the output achieved, or are linked to proving structural and process quality. In Germany, a number of low-threshold tools are available which can help small organisations in particular to address the issue of impact gradually and without a great expenditure of resources.<sup>46</sup> In addition, larger organisations can rely on the experience and services of evaluators who analyse most of the larger individual projects with the help of customised evaluations. Nevertheless, the hurdles posed by impact analyses are often difficult to overcome. Great challenges remain in the sense that impact-analysis instruments must first serve the varying demands for knowledge expressed by investors and social organisations; second, they must be applicable to the social organisation involved; third, they must be of good methodological quality – combining usability, feasibility, fairness and accuracy – in the sense of evaluation standards; and fourth, they must be able to reflect the problems and concerns of those addressed by the social services. Moreover, impact-analysis methods need to be generalisable, so they can be used to compare different organisations and projects. The tension between these goals is illustrated in Figure 11; while Approach B shows a successful balancing of the stakeholders' various needs.

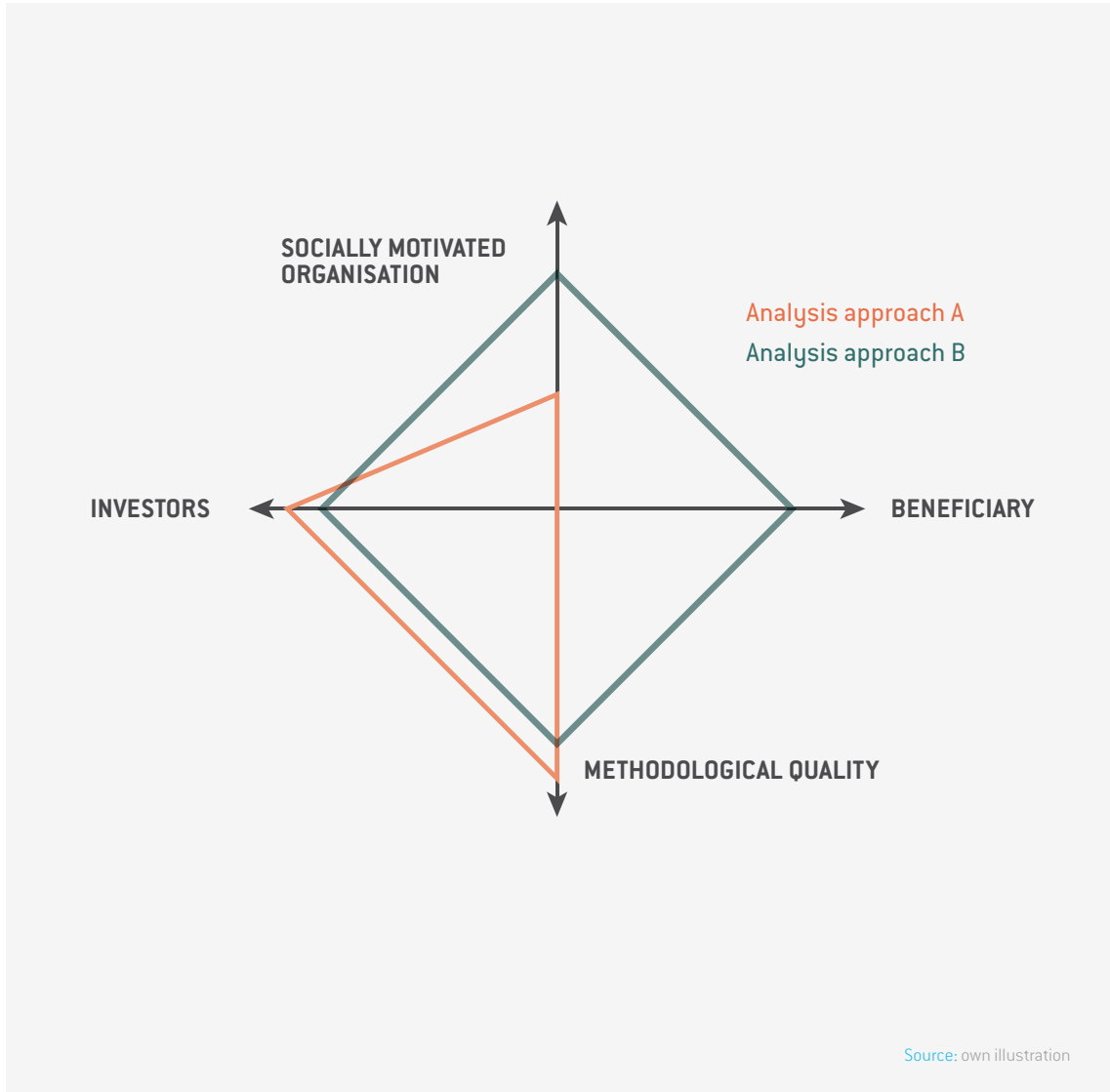
43 Schimanke (2000)

44 Stötzer (2009)

45 Phineo (2013)

46 Phineo (2013)

Fig. 11: Tensions and stakeholders involved in impact analysis



### What information must impact analyses provide to German investors?

With specific regard to the selection, comparability and monitoring of social impact investments, impact analysis plays a key role for investors. They require analyses, comparability and reporting standards in order to evaluate the predicted social and/or ecological returns associated with potential investments. Investors make this demand independently of whether they are primarily targeting social impact or whether financial returns are also important to them.<sup>47</sup> However, there remains a lack of comprehensive and fundamental empirical knowledge that can satisfy the needs of social investors; accordingly, it remains a fertile field for continuing research and dialogue between the various SII actors.

Over the course of discussions within the NAB, participants not only cited revisions to the legal framework for social organisations, management structures and the efficient use of resources<sup>48</sup> as being important to the field's success but also the standardisation and dissemination of impact measurements and analyses.<sup>49</sup> Some investors go a step further and demand that the distinction between financial and social or ecological reporting be eliminated, as these aspects are mutually interdependent. These investors argue that a comprehensive reporting mechanism that encompasses financial, social, ecological and even moral and psychological aspects – and thus the promotion of (social) start-ups – is essential in order to attract more investors, particularly in the area of (social) venture capital.

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In the eyes of some investors, a more sustainable investment behaviour could be developed through regulatory measures such as broader disclosure obligations for companies and issuers of financial products, in order to comprehensively document all sustainability risks and environmental impacts. Moreover, some investors advocate the implementation and standardisation of eco-ethical, social, cultural and economic measurement criteria and ratings measures for enterprises and capital investments.<sup>50</sup> However, due to the widely varying contexts, conditions and types of impact sought in different fields of the social sector, any effort of standardisation or binding requirements must involve a sustained dialogue with practitioners in the social sector.

As a first step, the Social Impact Investment Taskforce's international working group on impact analysis has prepared guidelines for Good Impact Practice that draw on previous experiences of evaluation, monitoring and quality-development efforts. The focus of this document is tailored strongly towards decision-making processes in the context of social impact investments; however, the essential points of the guidelines are applicable in all areas of social impact analysis. The tensions implicit in impact analysis outlined in Figure 11 are explicitly addressed in these guidelines, and the benefits of effective impact analysis for all stakeholders are integrated. These seven guidelines follow a cycle of impact analysis based on the following four general steps: “Plan”, “Implement”, “Analyse”, and “Verify”. These guidelines are briefly explained in the following table.

48 Fulton, Kasper & Kibbe (2010)

49 Scheuerle, Glänzel, Knust & Then (2013)

50 Bozesan (2012)

PLAN	<b>Set goals</b> A clear investment thesis and/or Theory of Value Creation (ToVC) forms the basis for strategic planning and ongoing decision-making, provides guidance for sourcing and due diligence, and serves as a reference point for performance throughout the life of an investment.
	<b>Develop Framework &amp; Select Metrics</b> An effective impact framework outlines how specific metrics are used across the entire impact measurement process; it includes metrics and a description of the logic for how they are applied to the portfolio. It also acknowledges the needs and perspectives of various stakeholders.
DO	<b>Collect &amp; Store Data</b> Efficient and effective data collection, and management of performance data, takes into account the necessary information technology, tools, resources, human capital, and methods used to obtain and keep track of data. It is also differentiated by distinct actors in the process.
	<b>Validate Data</b> A complete and transparent presentation of results includes sufficient information (to cross check calculations and assumptions against known data sources) and also provides an audit trail.
ASSESS	<b>Analyse Data</b> Comparable data analyses utilise standard, objective processes where possible in order to produce widely understood and actionable results.
REVIEW	<b>Report Data</b> Effective data reporting is evidence-based, aligns with stakeholder expectations about depth of information covered, presents information in a coherent manner, and enables comparisons and decision-making.
	<b>Make Data-Driven Investment Management Decisions</b> An effective review of investment results includes an assessment of stakeholder feedback about reported data as well as recommendations for actions needed to address changes to the ToVC/investment thesis.

Source: Impact Measurement Working Group of the Social Impact Investment Taskforce established by the G8 (2014)

Overall, the international debate on methodological issues has picked up speed in the last decade,<sup>51</sup> as have the first attempts to standardise reporting on organisational capacities and achieved impact.<sup>52</sup> The Global Impact Investing Network's (GIIN) efforts to develop suitable indicators for a standardised impact measurement as a basis for social and ecological investment decisions are particularly prominent. Performance indicators for a variety of topics have been collected and made freely accessible through an online platform called IRIS.<sup>53</sup> Worldwide, more than 5,000 organisations are already using the IRIS indicator system in order to monitor and communicate successful social and ecological impact. In Germany, along with the Gesellschaft für Evaluation, a number of actors particularly in the area of social start-up and risk financing (social venture capitalists or venture philanthropy), as

51 See, for example, the activities of the following organisations: DeGEval ([www.degeval.de/nc/home/](http://www.degeval.de/nc/home/)), SIAA ([www.siaassociation.org/](http://www.siaassociation.org/))

52 See: [www.social-reporting-standard.de/](http://www.social-reporting-standard.de/)

53 See: [www.iris.thegiin.org/](http://www.iris.thegiin.org/)

well as organisations such as PHINEO gAG, are either developing their own impact-analysis methods or seeking to use unified reporting standards for the assessment and monitoring of their portfolio organisations.<sup>54</sup> Under the leadership of the Social Impact Analysts Association (SIAA), going forward known as Social Value International (SVN), a study by the University of California, Los Angeles (UCLA) is currently researching impact analysis designs in past social impact investment deals.

## Outlook

In order to strengthen social impact investing in Germany, the further development and dissemination of effective methods of impact analysis is essential. To this end, the experiences of German and internationally active evaluation societies must be taken into account and new, low-threshold approaches to impact analysis must be used. Over the long term, impact analysis should be established and used in a way that is analogous to financial accounting, as an information source for current and potential investors and as a decision basis for (social) enterprises.

A cultural change in impact reporting is important for socially motivated organisations. Indeed, it enables impact to be targeted over the long term, allowing impact analyses to be used as learning instruments and as a basis for decision-making as well as facilitating the identification of challenges and opportunities for improvement without fear of negative financial consequences. Investors' behaviour can accelerate or hinder this cultural change.

From the investors' perspective, transparency and comparability across different investment opportunities should be improved. This could take place through the integration of independent due-diligence processes in investment deals, for example. Likewise, a succession of standardised, quality-tested indicators for the improved comparability of achieved social impact should be developed, as it would also contribute to the much-needed strengthening of data quality in impact analyses.

54 Thus, BonVenture ([www.bonventure.de](http://www.bonventure.de)), for example, uses the Social Reporting Standard for all of its projects, while AQUAL Capital ([www.aqualcapital.com/](http://www.aqualcapital.com/)) uses an internally developed integrated evaluation model as the basis for a de-risking of investments which generate both social and ecological returns.





## CHAPTER IV.

### Social impact investing in developing and emerging countries

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Against the backdrop of investment behaviour that is growing increasingly aware of sustainability, interest is growing not only in social impact investing within Germany but also in investment by German actors in developing and emerging countries, both with regard to social and environmental impact. In these regions, social impact investing focuses primarily on microfinance institutions, enterprise creation, and small and medium-sized enterprises (SMEs) that integrate disadvantaged people at the bottom of the global income pyramid (Base of the Pyramid, BoP) into mainstream economic life.

#### Strong market growth

Experts estimate that the market potential for social impact investments in developing and emerging countries will reach \$1 trillion by 2020. Potential earnings could reach up to \$667 billion.<sup>55</sup> Currently, development banks provide the bulk of social impact investment financing. A survey by the Global Impact Investing Network (GIIN) revealed that although development financiers accounted for just 6% of the respondents, they represented the largest share of investment at 42%, followed by fund managers (34%), foundations (9%) and financial service providers/banks (8%).

In addition, the KfW Development Bank and the Deutsche Investitions- und Entwicklungsgesellschaft (DEG) both finance investment originating in Germany on behalf of the federal government, partly with the goal of achieving positive social and environmental impact in developing and emerging countries. For example, the KfW is an anchor investor and initiator of several structured funds (see Spotlight 5: “*Example of a KfW structured fund*”) that are open to capital investments on the part of private investors. With partners from the policy and financial sectors, the KfW has issued numerous funds that support financial institutions in developing countries, among them the *European Fund for Southeast Europe (EFSE)* and the *Microfinance Enhancement Facility*.

Professional fund managers run these funds and are responsible for incorporating other investors, along with several other tasks. Several of these funds are structured to include different risk tranches. Among other investors, the Federal Ministry for Economic Cooperation and Development (BMZ) acts as a supplier of social risk capital. Structured funds offer the opportunity to incorporate different types of social impact investors into the financing of the fund. Even “*impact first*” or “*impact only*” investors can choose a financing tranche here that fits their investment goal and risk-return profile. In the case of the Luxembourg-based SICAF fund, shares sold to impact investors within the framework of the fund correspond either to promissory notes (called simply “notes”) or equity “shares”. German development cooperation organisations have extensive experience in this area.

### Increasing interest in Germany

Due to the lack of a standard definition and the current early market phase, there is a dearth both of concrete data on the state of social impact investing originating in Germany and of transparency with regard to relevant instruments. Research based on expert interviews suggests that to date, few investors who reside in Germany explicitly make social impact investments in developing and emerging countries. Investors already active in the area often use KfW as a vehicle or they choose to channel capital investments through specialised asset managers who are usually located in Switzerland.

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Active engagement by German actors (e.g. German investors, foundations and intermediary organisations) is becoming increasingly important in international working groups for the purposes of knowledge exchange and identifying innovative approaches and best practices. It also makes a valuable contribution to the international harmonisation of approaches and initiatives (particularly in the area of impact analysis). For example, within the framework of the Social Impact Investment Taskforce's international working group on impact analysis, the knowledge of experts from German institutions has been included in the development of guidelines for impact measurement. In the area of green investment, the number of international forums and networks is steadily increasing, with German development cooperation organisations already engaging with relevant national and international actors.

## SPOTLIGHT 5

### Example of a KfW Development Bank structured fund<sup>56</sup>

The European Fund for Southeast Europe (EFSE) is a microfinance fund with development-policy goals governed by Luxembourg law (SICAV). The KfW Development Bank has intensively supervised the construction of what is today the world's largest microfinance fund and is also its main funder.

The EFSE is financed through capital provided by participating countries, international financial institutions and private investors. The existing capital provided by the investors forms a so-called 'first loss tranche', that is, the first capital to be used should the fund incur losses. Other risk tranches are matched to the risk and return requirements of other investors. Currently, about €850 million is being made available through the EFSE, about 15% of which comes from private investors.

Almost three-quarters of the fund's commitments (i.e. the uses of the fund's resources) go to micro, small or medium-sized enterprises (MSMEs); the other portion goes to households as housing loans, particularly for housing improvements (e.g. energy conservation). The average loan amount is around €5,750. Partner institutions include local commercial banks, microfinance banks and other microfinance institutions. The EFSE offers the following financial products: medium to long-term loans, subordinated loans, equity investments, savings deposits, bonds and guarantees. Professional fund managers Oppenheim Asset Management Services and Finance in Motion manage and advise the fund.

EFSE's great success has led to similar funding approaches in other regions, including the Microfinance Enhancement Facility, a finance-sector fund founded in 2009; the Green for Growth Fund Southeast Europe, the Africa Agriculture and Trade Investment Fund (AATIF) and the Global Climate Partnership Fund. EFSE has also received various international awards. For example, at the Seoul G20 summit in November 2010, following a worldwide voting process, the fund won first prize for its innovative and crisis-proof model for the financing of small and medium-sized enterprises.

## SPOTLIGHT 6

### Risk reduction through risk pooling and the provision of "catalytic capital"

Social impact investors who are active on the capital market must be offered an adequate risk-return relationship. Overall, there are numerous funding approaches whose feasibility and usefulness emerge as a result of time- and region-specific funding needs. In specific market situations, public sector investors can encourage investment in developing and emerging countries through the temporary support of return and/or risk components.

In addition, the design of the regulatory framework and the provision of information (as a public good) act on both the risk and return aspects of investments.

The International Development Cooperation Working Group has expressed its scepticism toward approaches that use tax-based incentives for investors (such as tax-free yields) to artificially increase investment returns in comparison to other instruments. This approach has a notable disadvantage: on the one hand, it entails the loss of the public sector's ability to steer funding towards specific projects—as long as the private investor indicates their financial support of a "good cause," he or she receives the financial benefits, regardless of the quality or sustainability of the project. On the other hand, it requires an elaborate verification procedure or set of conditions to qualify for the tax exemption.

The working group concludes that it is useful to facilitate access to this market for return-oriented investors through temporary reductions in perceived or actual investment risks. These instruments then benefit only those projects and measures which are not currently served by the market and which the investment facilitator deems useful from a development-policy perspective. In this regard, public and private resources can be used in an efficient manner which is two-fold as risks are minimised through instruments which specifically 1) enable the diversification of project risk across a basket of investments (be they in a fund, private-sector enterprise or pertaining to a financing situation) and which 2) to the greatest extent possible, hedge the investment risks that the market has not yet fully analysed or is not yet ready to accept in full to the greatest extent possible.

It can be useful to differentiate between the various risks and market situations, for example, through the construction of special hedging instruments for political or currency risks (MIGA, TCX). Broader still is the approach of hedging investment risks through commercial equity in the form of risk buffers. This equity then hedges against all types of risk equally, including: credit, currency, weather, market, political and technological risks among others. However, the facilitator should create a risk buffer no larger than that which—judged by ordinary standards—would render probable an investment by a professionally active private-sector investor in a specific market situation.

This risk buffer should be re-examined over the course of time and for new projects; in all likelihood over time the desired private investment can be achieved with a reduced buffer, as the actual or perceived risks will have declined. The need for dynamic adjustment exists at two levels: a) dynamic adjustment of the risk buffer is required during the course of a single investment project (phase-out of public funds/exit in accordance with market development) and b) dynamic adjustment of the funding criteria is necessary, thereby changing the body of eligible investments (target investments).

An example of a public risk buffer would be an equity-like instrument that creates a risk buffer through state equity participation in a private enterprise or fund. This could either be at the level of a commercially acting, private-market parent company, or at the level of an investment company (public-private partnership). Both forms of participation represent a type of enterprise financing. They do not differentiate according to individual project risk. Rather, the risk buffer helps at an aggregate level, both independently of whether the parent or investment company experiences financial difficulties in individual projects and regardless of any de facto risk which may arise as a result.

It is the economic viability of the enterprise, rather than that of individual projects, that should be the target for protection. An enterprise “strengthened” in this way can refinance itself in later, more standard capital-market rounds. This can take place in the form of newly issued shares (equity), participation rights (mezzanine capital), or through borrowing (debt, rated where applicable). In this context social impact investors are the supported enterprises (for investments that are useful from the perspective of development or climate policy), and the financiers that contribute to a fund on terms that ensure capital preservation. Examples of this efficient style of public-resource allocation include KfW subsidiary DEG, a financing institution that specialises in private-sector financing with positive developmental effects, as well as globally and regionally structured funds that promote standardised investment goals (e.g. refinancing microfinance institutions in developing countries) such as the EFSE structured fund, created with support from BMZ and KfW.

## SPOTLIGHT 7

### Overview of investors in the area of social impact investing in developing and emerging countries

The following is a non-exhaustive list of German investors in the area of social impact investing in developing and emerging countries. Since many German investors conduct their investments through specialised asset managers or banks in other German-speaking countries, a selection of such related actors is also considered here:

#### Public-sector investors

- KfW Group
  - DEG
  - IPEX
  - KfW Development Bank
- Federal Ministry for Economic Cooperation and Development (BMZ)
- Federal Ministry for the Environment, Nature Conservation, Building and Nuclear Safety (BMUB)

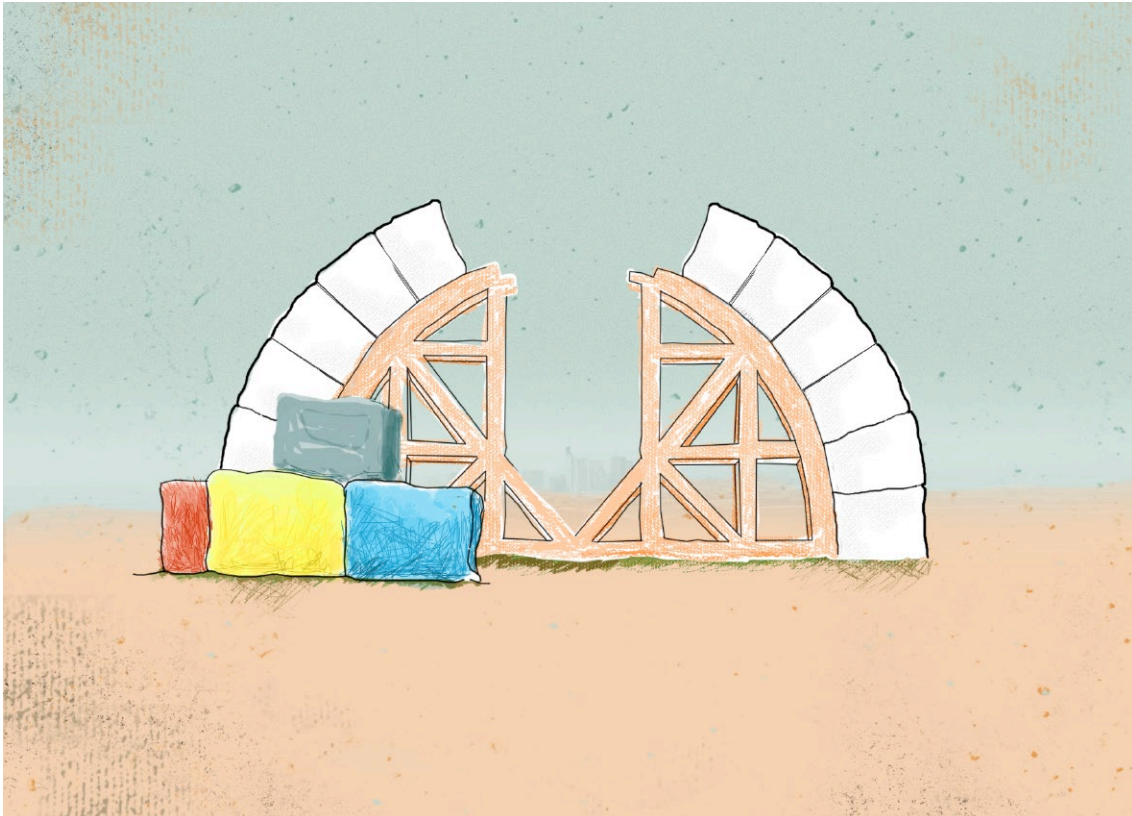
#### Non-public-sector investors

- Institutional investors
  - *Commercial banks*
    - Deutsche Bank AG
    - Credit Suisse
    - UBS
    - Lombard Odier
  - Church or ethically oriented banks
    - + Bank im Bistum Essen
    - + Evangelische Kreditgenossenschaft eG
    - + Oikocredit: Ecumenical development cooperative
    - + Bank für Kirche und Caritas
    - + Steyler Bank
    - ProCredit /ProCredit Holding
    - GLS Bank
  - Pension funds
    - Pension fund for the federal state of Brandenburg
    - Ärzteversorgung Westfalen-Lippe
  - Specialised asset managers (Germany-Austria-Switzerland region)
    - Finance in Motion
    - Invest in Vision
    - ResponsAbility
    - LGT Venture Philanthropy
    - Symbiotics
    - Azure Partner
    - Bamboo Finance
    - Quadia
    - Impact Finance
    - Blue Orchard
    - Absolute Portfolio Management
  - Family Offices
  - Foundations
    - Canopus Foundation
  - Retail investors
    - *High-net-worth investors* (qualified investors)
    - *Small investors*



## CHAPTER V.

### Conclusions and recommendations

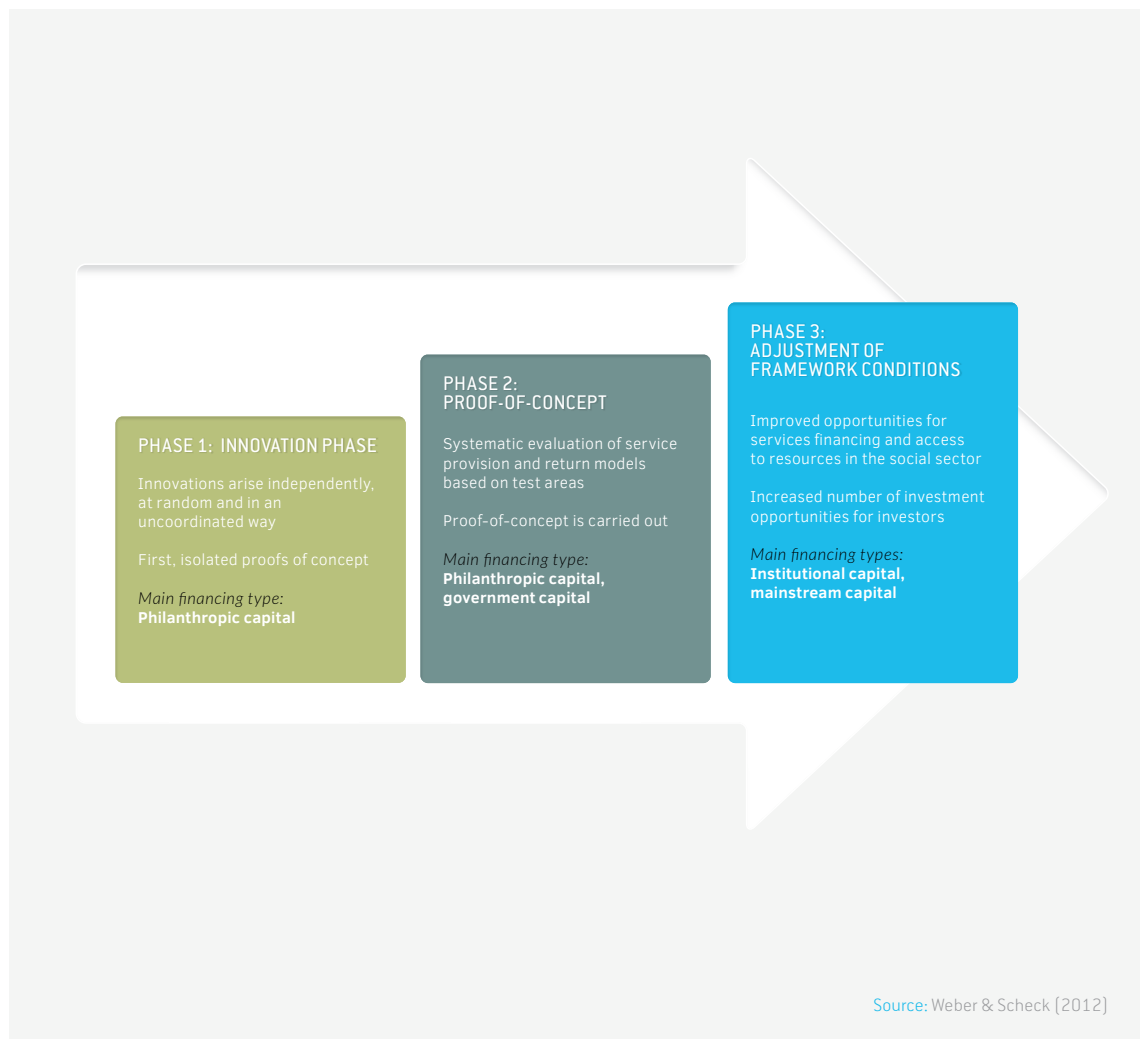


The primary aim of this report was to provide an initial assessment of the circumstances within which the financing approach known as social impact investment could strengthen the existing financing system of the German social sector against the backdrop of international developments. Over the course of this paper several specific issues have been considered: the need for investment capital of this kind within the German social sector; the existing and potential supply of capital by social impact investors; the requirements for impact analyses; and the framework conditions necessary for the future development of SII in Germany. In addition, this report examined the use of SII at the international level within the framework of development cooperation.

### Market conditions and recommendations for further development

The SII market in Germany, i.e. the space in which supply and demand for impact-oriented capital meet, remains at a stage of experimentation and innovation (Phase 1). In order for further market development to be achieved, a “*proof of concept*” phase (Phase 2) is required, in which a systematic test of SII-financed services can be conducted in selected areas of the social sector. If SII is to be further developed and gain long-term systemic relevance, targeted models or pilot projects must be employed to test this relatively new financing approach. On the basis of the insight gained from this process, adjustments to the legal framework can be made (Phase 3), in order to stabilise the use of SII in Germany and incorporate it into the existing financing system of the social sector. Figure 12 depicts a multi-phase model of this kind, which could be used to develop an SII market. The recommendations listed in this chapter must be understood as being directed at the transition from Phase 1 (innovation) to Phase 2 (proof of concept).

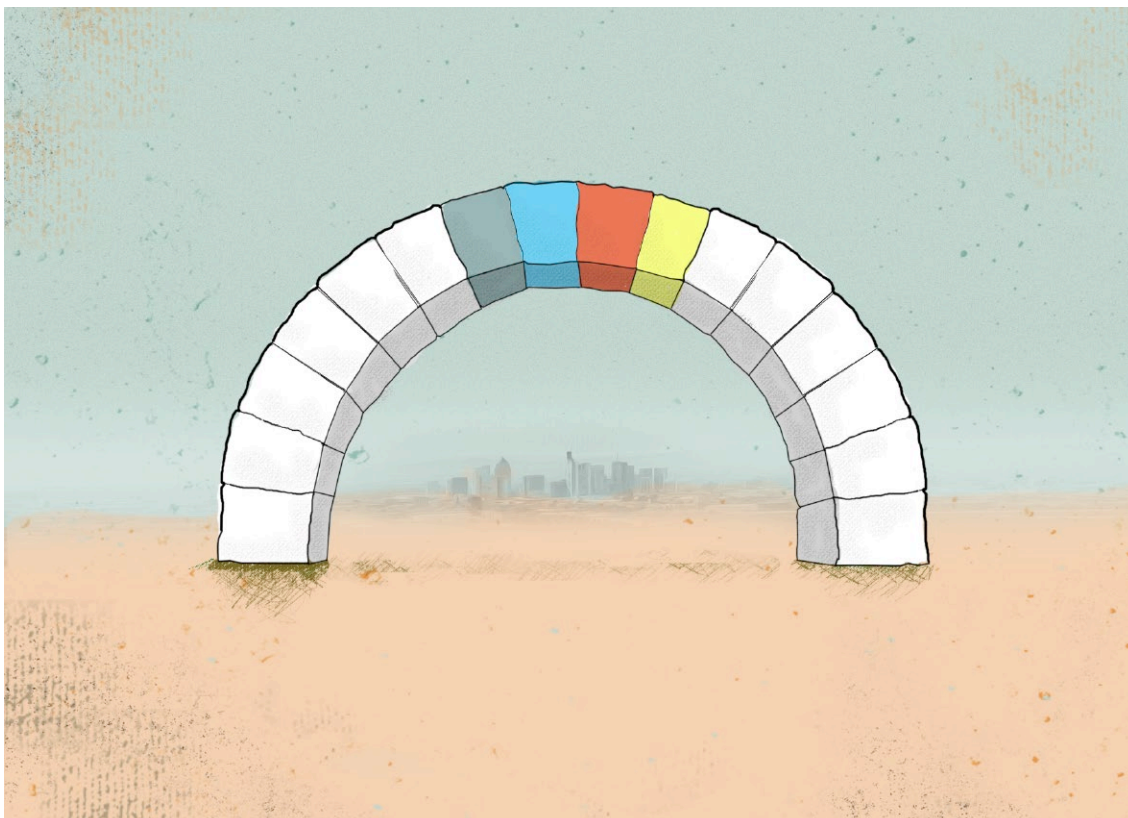
Fig. 12: Possible multi-phase model to develop an SII market





## Demand

Social, demographic and environmental challenges increase the demand for prevention, innovation and scaling up activities related to social service delivery in Germany. At the same time, it is becoming increasingly clear that the system currently used to finance social service delivery in Germany creates insufficient incentives for developing these kinds of solutions. There is a distinction to be made



between the “inner circle” of the social welfare system (with its guaranteed financing) on the one hand, and the “outer circle” (with its largely voluntary financing, in which innovation and preventative measures should be more strongly developed) on the other hand. The objective of a systematic deployment of SII in Germany should be to increase the overall volume of financing provided for the development of impact-oriented solutions to social challenges. This goal should be attained especially through facilitating and expanding the financing of innovative and preventative approaches. SII also seems particularly suitable for use in non-case-specific social work, which today suffers from non-existent or insufficient statutory financing. Against the background of the interplay between innovation, prevention and scaling up activities on the one hand, and effectiveness and efficiency in the statutorily financed area on the other hand, the careful selection of suitable areas and the finely tailored integration of SII into proven structures of social-service provision and financing is an essential factor for success. In short, the use of SII should fundamentally complement existing resources, and should not prompt a debate over expenditures and spending cuts. Rather, it should broaden and strengthen the existing financing system in the social sector.

In order to nurture demand in its early stage of development, it is necessary to implement measures aimed at building the knowledge and networks of engaged and interested actors. For the sake of potential investors, existing business models within the social sector must be rendered investable, and start-up projects in the social sector must be supported and promoted in a more targeted way. Through state-supported SII funds, possibly with a regional focus, new incentives for the implementation of prevention, innovation and scaling up activities in selected areas of the social sector can be created. In addition, there are currently legal uncertainties for socially motivated organisations that want to be able to pursue social impact alongside their usual economic goals. A closer examination of necessary legal conditions could be useful in this regard. One additional medium to long-term objective concerning the implementation of pilot projects is the further development of social-law regulatory systems through the development of successful prevention models. Consequently, the following specific recommendations are offered:

## Recommendations

	OBJECTIVE	MEASURES TO BE TAKEN	ADDRESSEES
1.	Strengthen perception of SII as relevant additional financing source for socially motivated organisations	Strengthen the information base in the SII market by:  Publishing regular market reports that provide information about market developments (quantitative as well as qualitative methods, based on international standards of data collection and monitoring);  Researching the needs of possible investees in order to enable intermediaries to provide appropriate services.	Foundations, the social sector, social-sector disseminators (e.g. associations), investor groups, intermediaries
2.	Cross-sector cooperation to create business models which include social impact	Create and develop cluster networks/hubs akin to those of existing infrastructure in the technology sector.	Social sector, social-sector disseminators (e.g. associations), investors
3.	Promote investability for business models available within the social sector	Strengthen advisory resources such as specialised intermediaries.	Foundations, public sector
4.	Support social sector start-up companies	Apply existing tools for economic development to the case of social entrepreneurs and socially motivated organisations, particularly by making non-profit organisations eligible for existing support programmes (e.g. through public promotional banks).	Public promotional banks, state
5.	Create incentives for the implementation of prevention, innovation and scaling-up in selected areas of the social sector	Examine the opportunities to direct SII into these areas, e.g. through government-supported, regional SII funds created for prevention, innovation and scaling up. These funds would be used to address the issue of cost savings not accruing in the budgets of the public entities who invested in preventative measures.	Public sector
6.	Enable the simultaneous pursuit of economic goals and social impact by socially motivated organisations without legal uncertainty	Examine legal requirements for the governance structures of hybrid organisations.	Legislative or regulatory bodies, socially motivated organisations, social sector, foundations, academia
7.	Develop the social-law regulatory system further through proven impact-oriented preventative measures	Prepare successful, SII-financed prevention models with cost-benefit analyses for inclusion into the statutorily financed welfare system.	Legislative or regulatory bodies (public agencies)

## Supply

Investors are showing an increasing interest in the social impact of investment capital and thus an affinity for SII as a basic principle. However, the majority of existing information concerning investor motives and behaviour is derived from SRI research and is therefore only partially transferable. The remaining gaps in knowledge should be addressed empirically on the basis of independent studies (e.g. through surveys). It is already apparent that the willingness to invest differs starkly from one type of investor to another. This is primarily contingent on the prevailing statutory or regulatory framework. The investing potential of HNWI, foundations and family offices, as well as that of retail investors in the medium term, should be emphasised. However, some interviews previously conducted make it clear that HNWI, foundations and family offices still perceive strong barriers to their engagement in SII. The reasons they mentioned include fear of a problematic risk-reward relationship, very high administrative expenditures (at all investment phases), a lack of financial products suitable for investors, too few existing SII best practices, a lack of intermediaries able to provide support (particularly expert advisors), and too few specific investment opportunities (i.e. socially motivated organisations). These circumstances explain the high degree of uncertainty expressed by foundations and HNWI regarding SII in Germany. Foundations in particular have noted that unresolved questions still remain, such as possible breaches of fiduciary duties if an investing foundation's capital endowment were to be eroded through SII-related capital losses. In addition, one of their critical concerns is the possibility of violating their non-profit status. Overall, foundations regard the regulatory environment of SII as not sufficiently clarified yet.

Professional investors primarily assess an investment in relation to a so-called 'portfolio context'. Rather than an isolated consideration of the risk-return profile, a given investment will be judged in terms of its contribution to an existing or envisioned asset position. In this regard, an understanding of the interplay between risk/reward and social impact, and the integration of SII into multi-asset portfolios is of crucial long-term importance. Further scholarly research is therefore particularly important in order to facilitate professional investment decisions. Going forward, the financial sector/investor community must now acquire the necessary competences to use SII in social sector activities, while taking into consideration the limitations and potential of SII in this context, as identified in the NAB's assessment outlined here. Key action could take form, for example, through the (further) development of appropriate financing vehicles.

A targeted development of knowledge and exchange between interested actors is also necessary in order to support the further development of the supply side through the attraction of additional investors. For example, this development could take place with the help of organisational or network-based advocates for SII, as well as through the creation of extensive advisory services for interested investors. A stronger integration of influential investor groups, such as foundations, retail investors and—in the medium to long term—certain institutional investors, presupposes the creation of legal certainty, appropriate incentives and well-tailored financial products. This integration will require the further development and dissemination of financial instruments conducive to social impact, as well as public-sector and philanthropic offers of risk sharing in order to attract potential social impact investors. The following specific recommendations are offered:

## Recommendations

	OBJECTIVE	MEASURES TO BE TAKEN	ADDRESSEES
8.	Expand knowledge about the investment opportunities available in the social sector	<p>Strengthen SII-market information (see the related recommendation under “Demand”).</p> <p>Create an information platform for financial instruments, financing offers, specific search profiles and investment opportunities.</p> <p>Research the needs of potential investors, in order to enable intermediaries to provide appropriate services.</p>	Foundations, socially motivated enterprises, social-sector disseminators (e.g. associations), investor groups, intermediaries
9.	Promote knowledge exchange/cooperation and interest advocacy	Create or strengthen networks/organisations that can be advocates for SII and mission investing. Lobby for necessary legal changes and promote knowledge exchange.	Individual groups of market participants (e.g. investors, investees, intermediaries)
10.	Develop advisory services for investors interested in SII	Create or strengthen specialised intermediaries that provide investors with investability assessments (due diligence).	Financial sector (banks, investment groups, consultants)
11.	Facilitate the involvement of foundations in SII	<p>In the context of the Association of German Foundations' mission investing initiative, capital-rich foundations in particular could voluntarily commit to investing a certain percentage of their assets (e.g. 10%) up until a specific future date (e.g. 2020) in mission-related investments or SII.</p> <p>The Association of German Foundations should create incentives for foundations to systematically and regularly report on their mission investing.</p> <p>Create legal certainty with regard to foundations' non-profit activities in the SII area and the related financial effects on foundation capital in cooperation with tax- and foundation-law regulators.</p>	Foundations, Association of German Foundations
12.	Increase the participation of private retail investors in SII	<p>Develop new SII products for private investors.</p> <p>Develop and expand specialised crowdfunding platforms to finance socially motivated organisations.</p>	Banks, intermediaries, existing crowdfunding platforms
13.	Adapt existing regulatory constraints for institutional investors such as pension funds and (life) insurance groups so as to enable comprehensive SII investment	<p>Explore the development of new or adapted investment forms that better facilitate participation in SII under the current regulatory framework (e.g. G-REIT, social impact bonds).</p> <p>Examine whether new or existing secondary markets (exchanges) or other forums can be created, used or adapted to enable social impact investors to divest their SII investments to other market participants.</p>	Financial sector (banks, exchanges, pension funds, consultants), academia

	OBJECTIVE	MEASURES TO BE TAKEN	ADDRESSEES
14.	Expand the supply of SII instruments	Develop additional social impact financing instruments such as social impact bonds or hybrid financing models which are able to combine philanthropic resources (donations) and repayment-based social impact capital.	Investment groups and banks, foundations
15.	Close the financing gaps for socially motivated organisations in early phases of enterprise growth	Create an early-phase investment fund for socially motivated organisations analogous to high-tech start-up funds or based on the structured funds present in development cooperation.	Public promotional banks, foundations
16.	Enable risk sharing for potential social impact investors in the innovation or “proof of concept” phase	Broaden the supply of risk capital with co-investments, e.g. through funds of funds.	Public promotional banks
		Develop guarantee instruments/special guarantees to support SII product providers.	Foundations

### Impact analysis

Impact analysis is steadily gaining importance within Germany's social sector. Despite this trend, many social organisations and socially motivated enterprises have only taken initial steps towards its consistent implementation. This presents a significant obstacle to attracting additional social impact investors, as they base their investment decisions to a significant degree on the verifiability of positive social impact. These investors want a comprehensive form of reporting that does full justice to social and ecological perspectives as well as to financial and economic outcomes. For socially motivated organisations as well, finding a suitable form of impact analysis would unlock considerable potential for their own further development. However, it remains essential that this be accomplished with an expenditure of resources that is appropriate to each respective organisation.

Creating standardised terminology and independent social due-diligence processes would establish two cornerstones that would enable greater transparency and comparability within the developing SII market. It would be useful to examine whether appropriate reporting mechanisms are being used within individual sectors. If the needs of social impact investors are to be met, a gradual development of indicators and an augmentation of the existing data store will be essential. These developments cannot happen without a strong consciousness of the added value of impact reporting within the social sector. The following specific recommendations are offered:

## Recommendations

	OBJECTIVE	MEASURES TO BE TAKEN	ADDRESSEES
17.	Strengthen understanding of the added value of impact reporting	<p>Create a change in the culture of impact reporting, in order to:</p> <p>Enable organisations to focus on long-term impact creation;</p> <p>Utilise impact analyses as learning instruments;</p> <p>Be able to identify challenges and improvement opportunities without fear of negative financial consequences.</p>	Socially motivated organisations, investors, foundations
18.	Create standardised terminology	Introduce standardised terminology to improve understanding across individual sectors as well as be able to profit from international experiences to the greatest degree possible, or enable comparability at the international level.	Socially motivated organisations, investors, academia, foundations
19.	Increase transparency and comparability for investors	Create independent social due-diligence processes as a part of investment deals.	Socially motivated organisations, investors, intermediaries, foundations
		Examine appropriate reporting provisions for individual sectors, in order to establish adequate and generally recognised regulatory, service and impact standards for the reporting process. Existing guidelines and instruments can be adapted for this purpose.	Socially motivated organisations, investors, foundations
20.	Create indicators	Steadily develop standardised quality control indicators for individual fields within the social sector.	Socially motivated organisations, investors, academia, foundations, social sector
21.	Expand existing data in order to improve transparency and comparability	Improve data collection in terms of its scale, scope and systematics, as well as the processing of existing data (both financial and impact-related).	Socially motivated organisations, investors, academia, foundations

### Social impact investments in developing and emerging countries

In order to reinforce the mobilisation of German actors to make investments with positive social and environmental impact in developing and emerging countries, the following recommendations are offered:

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#### Recommendations

	OBJECTIVE	MEASURES TO BE TAKEN	ADDRESSEES
22.	Raise awareness, promote the provision of information and facilitate exchanges of experiences among social impact investors	<p>Perform targeted events to raise awareness among German actors (in particular institutional investors and foundations), drawing their attention to the challenges, opportunities and contacts available for social impact investment in developing and emerging countries.</p> <p>Support learning and dialogue platforms in order to further develop the German investment environment, exchange of experiences in international forums, and learning from experiences in other contexts.</p>	(Financial) intermediaries, foundations, associations, public sector
23.	Develop infrastructures for social impact investing	<p>Help organisations in developing and emerging countries to become investment-ready in order to increase the quantity and quality of investment opportunities.</p> <p>Target development and expand the contributions to learning and dialogue platforms to improve market transparency, make successful investment vehicles more accessible and to encourage potential investors to learn about relevant legal conditions.</p>	Foundations, (financial) intermediaries, universities, public sector
24.	Take risk-reduction measures for commercial investors	<p>Reduce the actual or perceived risk of social impact investments in developing and emerging countries, through:</p> <p>Risk-pooling at the level of funds, enterprises or financial institutions (see Spotlight 6);</p> <p>Provision of appropriate risk buffers (see Spotlight 6);</p> <p>Strengthening the institutional capacity of financial intermediaries, financial institutions and enterprises in developing and emerging countries that invest in or finance SII.</p>	Foundations, (financial) intermediaries, development banks, public sector



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