How to **finance** your social impact

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ScaleUpNation

April 2021

How to finance your social impact

As an impact scale-up, you need to organize for capital that will support you in accomplishing your goals to scale both your business and your social impact. This involves three main elements: focussing on your main aims, building your case, and developing relationships with the right investors.

In order to scale your impact and profit, management teams have to organize for fitting capital: to get the right investors who support your dual aims and are willing to do so long enough for you to actually be able to scale your impact. How to make this happen? You need to do three things: 1) keep an eye on your long term goals; 2) build a strong case for investors quantifying both your impact and business accomplishments, and 3) develop relationships with the right investors by putting significant effort in matchmaking and trust building.

Focusing on your main aims

In order to organize for patient capital you need to have a clear perspective on your long-term aims for both profit and impact, and not lose sight of it in the process of interacting with potential funders. Not all funding is helpful, and some might even throw you off course.

As you are building a young, innovative organization with real potential for positive societal impact you are likely to receive attention from a wide range of actors and run into different types of opportunities to gain some funding. However, not all of these opportunities will necessarily help you scale your impact in the long run. Martin Schuurman, the founder of Tonify Loyal Capital, sees a problematic practice of impact entrepreneurs spending most of their time on attracting finance and failing to factor in whether this funding truly supports their growth and mission in the long run. "They feel like they have to take anything they can get, but capital that is not aligned with the meaningful mission can backfire." Pablo Van Den Bosch, the founder of Madaster, has learned to be more selective: "We go for investment capital. We cannot rely on philanthropy because it is not sustainable."

Take, for example, subsidies and grants. They are often seen as 'free money', yet our research indicates that this is not the case. In fact, our data show that 62% of scale-ups are independent of subsidies compared to 36% of stall-ups (see Figure 1).

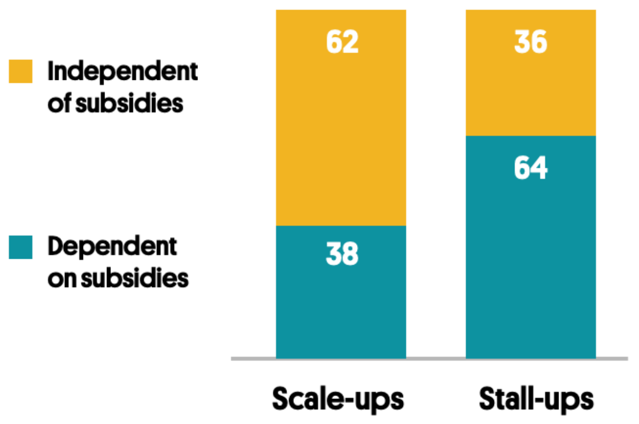

Figure 1. Dependency on subsidies among scale-ups and stall-ups. The results are based on a database of 131 companies, all less than 10 years old, with an innovative product and typically with external funding, based in the Netherlands, with revenues across a wide range of industries.

In an efficient market for investment capital, enterprises with scale-up potential should be able to get growth funding at competitive terms. Often, subsidies or grants are only provided in case of market failure. However, market failure also means that scaling will prove difficult. Subsidies and grants tend to come with their own incentives that shape your decision making and create high administrative burdens. "We had a negative experience with raising subsidies", explains Michael Utkin, the CEO of eFarmer. "It was a waste of time. We were trying to address the specific issues that the subsidy provider required, we spent a lot of time on that instead of building the product and attracting more customers. As a company we should concentrate on bringing our products to customers."

There is no one size fits all for funding. For any type of funding, only go for funding of things you already want to do (not opportunities that come to mind triggered by the availability of a certain subsidy). There might be cases in which subsidies will help you scale your impact, for example, if they allow you to advance your R&D efforts on your own commercially viable terms. However, stay critical about the implications of your funding decisions for your long term success.

Make sure you do not lose your flexibility through your funding decisions. In the highly uncertain, volatile, ambiguous context where most scale-ups navigate, the name of the game is agility, serendipity, undertaking many pivots, and not sticking to the initial plan. "When working with public funds, the main risk is that what you proposed when you applied for funding will not be relevant in two years", warns Olaf van der Veen, the CEO of Orbisk. "Of course, you can deviate from the original plan with the right motivation, but you need to convince your funding body and manage your relationships with it".

Building your case

To attract patient capital, you need to demonstrate that you are already making an impact, have delighted customers, and have a realistic plan how to grow both impact and profit. An investment-for-impact case often hinges on a "theory of change": a perspective on how you will impact a sustainable development goal. This perspective has to be reconciled with the business case for investors who are mostly interested in understanding how you are going to quickly increase the value of your company.

As an impact scale-up you can strongly position yourself to investors as bringing return on investment both in monetary terms and in positive societal impact. Investing in young, innovative firms with an attractive business model and a product or service that makes the world a better place can support a superior investment class. This is an improvement over investing in commercial-only ventures as these have a lower probability of scaling up. Impact investment is also superior to philanthropy as investing in real businesses leverages customer orientation, entrepreneurial drive and the focus on efficiency.

Building your case will require you to think about the value of your impact and how to bring this across to investors. Edith Kroese, the CEO of Avance, highlights how difficult this can be: "Impactful companies should be valued higher than non-impactful, investors should value impact, but there is a barrier to that. Impact is not money. How to value impact in money? Social impact (e.g., happiness, social cohesion, child labor, slavery) is not easy to translate into money."

How can you best demonstrate the value of the impact you are already making, and especially the future impact you are aiming for? Often this will involve finding a way to quantify both. Like Olaf van der Veen, the CEO of Orbisk argues: "Our growth results in impact directly, there is no conflict between them. But our story can be bigger and better. We need to spend time on quantifying our impact."

As your organization is still at an early stage of a learning journey, your initial impact will likely be disappointing. How do you communicate to risk averse impact investors in this case? Focus not only on your initial results, but also on your potential for future impact. Build your case around the impact you are likely to have in the future and make this as explicit as possible.

Developing relationships with the right investors

Extensive matchmaking to find and develop true fit will pay off in the long run. Find investors who fit your dual goals of profit and impact, and understand that they reinforce each other.

Investors have a large imprinting effect on a young organization. They are likely to push you in the direction that will leave a long term mark on your further development. On the one hand, it can be problematic to have funders from the public and social sector who have an uneasy relationship with commercial concepts like profitability and scaling. You need investors that can move beyond a balance sheet mentality to a growth mentality. On the other hand, problems arise if in a scale-up the board consists of commercial investors too eager to monetize the value quickly.

Your impact and profit goals are aligned because of your lock-step model that combines impact and profit in your offer. However, some trade-offs between impact and profit are bound to emerge along the way. Who will continue to support your dual aims when these trade-offs emerge? Even among impact investors it might be hard to find this match. "Money should not be leading in investment decision making", argues impact investment expert Pieter Oostlander, the founding partner of Shaping Impact Group.

“Money is a resource, not an aim in itself. Impact and profit involve trade-offs, and investors often have to choose between more profit and more impact. They need to find the balance between impact and profit. However, traditional investors often see impact as being secondary”.

As only what scales will move the needle on value creation *and* impact, it is important to find investors that will set you up for both. Investors that value the synergetic combination, instead of perceiving the combination as an inherent trade-off.

How we did our research

This article is part of a series of ScaleUpNation publications focused on scaling for impact. All are published under creative commons on the ScaleUpNation website.

There is no formula for scaling, but we identified what differentiates those that scale from those that stall. Learn all about our scaling model: The Art of Scaling.

The research into scaling impact was supported by Goldschmeding Foundation and included a review of the academic and practitioner literature, 45 interviews and 7 reflexive dialogues with impact scale-up leaders and experts, and database reviews of more than 3,500 organizations in the scale-up phase. The findings of this research are translated into papers, training programs and due diligence tools.

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