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Learning Outcomes

Module 3 – Financing the Social Enterprise

Introduction

No matter how meaningful your social enterprise might be, no matter how sturdy and supportive your customers and partners might look, without a good understanding of the cashflow cycles of your operations, without a financing forward thinking strategy, you are facing the risk of constantly chasing cash instead of focusing on growing your impact and activity, improving the quality of your operations and the relevance of your social enterprise to address the social challenge it originally aimed to tackle.

This module delves into cashflow cycles and the financing needs it brings about, explores different sources of finance you might tap into in order to address them. It eventually looks into financing strategy and a few questions worth addressing in order to ensure it best serves sustaining the enterprise.

Learning Objectives

Knowledge

- Understanding the difference between short term and long-term needs
- Recognising the sources of finance that are internal to the business
- Recognising the sources of finance that are external to the company
- Understanding the requirements/circumstances that need to be in place for the sources to work effectively
- Recognising the possible sources of issue that could negatively affect accessing these sources

Skills

- Being able to differentiate and plan short term and long-term business and cash needs
- Ability to analyse and manage the internal sources of finance of the business
- Ability to analyse and manage the external sources of finance of the business
- Ability to predict and manage relationships and processes to positively affect the sources of finance
- Skills required to manage sources of conflict and crisis that could negatively affect accessing sources of finance

Competences

- Managing the business's short term and long-term financial needs
- Managing the internal sources of finance to ensure maximum short term cash flow efficiency
- Managing the external sources of finance to ensure long term viability and investment
- Managing relationships and resource/payment mechanisms to ensure that planned cashflows remain viable
- Troubleshooting the circumstances that could negatively impact the planned sources of

Aim:	Performance criteria:
The objective is to create a framework to provide sufficient knowledge to assist social enterprises and SMEs to understand their financing requirements and to outline the options available to attract and manage sustainable sources of financial resources	The social enterprise / SME should be able to better understand the dynamics of their internal and external financial resources and to better understand the various sources of finance together with their respective advantages and disadvantages

The objective of this module is to create a framework to provide sufficient knowledge to assist social enterprises and SMEs to understand their financing requirements and to outline the options available to attract and manage sustainable sources of financial resources.
The social enterprise / SME should be able to better understand the dynamics of their internal and external financial resources and to better understand the various sources of finance together with their respective advantages and disadvantages

At the end of this module, you will have:

1) a good foundation of knowledge and understanding of what cash flow cycles are and how they impact the social enterprise,
2) an understanding of how to identify funding needs of the social enterprise and the different sources of finance you can tap into in order to meet them
3) a clear idea of how to use iteratively financial statements and forecasts in order to design a financing strategy that best serves your vision.

Detailed index

1) Overview of cash flow cycles
    a. Operating
    b. Investing
2) Overview of finance needs
    a. Short term financing requirements
    b. Long term needs
3) Basic tools to support finance needs appraisal
    a. How the three financial statements interact and integrate together
    b. The importance of cash flow forecasts and projections in order to assess operations, investment and resources required, time frames
4) Sources of finance
    a. Internal sources
    b. External sources
5) Financing strategy and how it impacts your enterprise
    a. Poor financial planning and estimates, short termism (quantity)

b. The importance of finding the perfect match (resources, financial partners)

Main Content

How social enterprise’s stakeholders (also) translate into financial streams

The social enterprise, while at the same time unfolding its activity and pursuing its social objectives, is operating in the middle of a very dense and intertwined system of actors, each with their own objectives and constraints.

As the Social Business Initiative from the European Commission puts it, a social enterprise „operates by providing goods and services for the market in an entrepreneurial and innovative fashion and uses its profits primarily to achieve social objectives. It is managed in an open and responsible manner and, in particular, involves employees, consumers and stakeholders affected by its commercial activities.“

How does this definition translate into financial streams?
Well, as an enterprise a social enterprise produces services and products translating into cash flows with very distinct timelines, which are depicted on this slide as orange arrows.

- **Clients** buy and pay possibly with a payment period (which can be quite long, up to 60 days according to European regulation, and very much depending on the sector, the local market and the negotiation leverage of the enterprise).
- **Users or beneficiaries** of the social enterprise, those stakeholders whose life should be improved because of your product or service, can be customers (possibly at an accessible price made possible by the hybrid revenue model you developed), or employees if you are a WISE, or trainees, etc.…Depending on their role and place in the model of your social enterprise they will generate inbound and outbound financial streams
- **Employees** are depicted here with a bidirectional arrow, as they get remunerated for their work within the enterprise, but can also invest themselves in the organisation while buying shares and becoming themselves shareowners. This is typically the case in cooperatives, but can also be organised in more classical for profits, all the more so that it describes itself as a social enterprise. This is also what is referred to in the SBI definition when it states that the social enterprise “is managed in an open and responsible manner and, in particular, involves employees, consumers and stakeholders affected by its commercial activities. “
- **Suppliers** needed during production are paid according to a certain term,
- **State and local government** receive taxes from the enterprise, and provide for tax cuts or subsidies to it, depending on the mission the social enterprise focuses on. They can in many cases themselves be customer of your social enterprise
- As an employer you provide for welfare insurance for your employees, thus contributing to **welfare organisations** accordingly

- Your **bank** usually grants short or medium-long term credit, which get paid for and reimbursed. It is also the recipient of and intermediary for the previously mentioned financial streams.
- **Members** of your organisation if you are a non-profit or **shareholders** in case you are incorporated as a for profit, both if you are hybrid, pay a membership fee and might receive in exchange discounts or access to product or services at a reduced price (although that is absolutely not systematically the case), while you might provide your shareholders with dividends in case you generate sufficient result to provide for sustainability of your action and fulfilment of your social objective. They might also be remunerated for their investment when exiting your enterprise, i.e., selling their ownership to another shareholder, possibly with a capital gain if the equity value of your enterprise has improved overtime.
- All these financial streams can be broken down in two separate cycles: one related to the daily operations of the enterprise, appropriately called **operating cash flow cycle**, the other focusing on the long-term value creation of your organisation, called **investing cycle**.

Overview of cash flow cycles

The operating cash flow cycle

The operating cash flow cycle relates to all inbound and outbound financial streams directly linked to your daily operations, from procurement phase to production, to actual sale of product or service.

You can visualize here the successive phase of the operation cycle:

- during procurement phase, while you have acquired a certain number of services or goods in order to produce your own service or product, you might benefit from a payment term. Until payment, which can be many days after actual delivery (hence the red arrows in the middle of the production phase), you are indebted to your suppliers. This operating debt is called account payable, and is part of your current liabilities. In the same way, your employees are being paid at the end of the month, hence giving you 30 days credit.

- After production, which can come with or without any cash in (depending on your activity and the profile of your customers); the marketing and sale phase leads to your customers buying your service or product and providing you with payment. Similarly, to your suppliers, you can as well grant them credit and allow them to pay you with delay. Those operating credit you granted or « account receivable » appear in your balance sheet as current assets.

The accounts receivable can also entail payment from grants you are receiving for part of your social mission. Grants can come with very specific payment terms, especially when they are project based.

Understanding your overall operating cycle, intertwining economic and social mission, is essential to allow its translation into financial forecasts.

Each activity has its own operating cash flow cycle, which repeatedly iterates

The investing cash flow cycle:

The investing cycle is on a different timeline than the operating cycle: while the latter focuses on your daily operations, investing cash flow cycles reflects the medium-long term vision and sustainability of your social enterprise;

Acquiring machinery, premises, developing a new innovative service or product involving research and development in the long haul, developing a new activity to better serve your beneficiaries while ensuring a sustainable dedicated business model, are all investments that are pursued alongside your daily operations, and eventually will impact them while :

- changing the way you produce (new equipment, new organisation), changing your product itself,
- changing your overall production process and possibly your operating cash flow cycle (if you scale your activity and improve your leverage vis-à-vis your suppliers, for instance),
- improving your impact while better addressing the needs of your beneficiaries or growing your capacity to reach more of them.

Overview of finance needs

Warm up:
Moving on to a general overview of the different finance needs your social enterprise is faced with, let's warm up with a small exercise and take 2 minutes to match each of the needs listed in the center of the slide with possible sources of finance identified in the orange and clementine boxes.

Warm up: solution
A quick look at possible solutions:

- While a car is to be used over the medium term, a medium-term loan is appropriate, as are leasing options.
- Hiring a new employee will be funded by the turnover you currently generate, as well as by the increased or more stable turnover this new addition to your team will generate in the future. A dedicated operating grant for the rolling out of a new social service for instance can also be identified as relevant to fund this hire.
- Number 3 directly relates with the previous slide on operating cash flow cycles where we mentioned the specific cash flow cycles of grants. Here, an overdraft facility or short-term lending can be granted by your bank if you can provide sufficient assurance as to the probability of actually receiving the funding.
- Recurring cash mismatch generated by your operations can be funded by banks (but this varies strongly from one country to another). In the medium term, the profit generated by your activity enables you to fund this working capital requirement with your own resources…until you take a new growth step that will generate another growing cash mismatch and a need for external funding.
- The losses generated by the development of a new activity, an inadequate cost structure, situational factors, are to be funded by the equity of the enterprise, that is the money that was injected overtime by the shareholders as well as the cumulated profit generated in the previous years and that have not been distributed (which is most generally the case with social enterprises). Especially when due to situational circumstances, exceptional subsidies can be granted to social enterprises to help them recover faster.
- The rent belongs to operating charges, just like payroll, and as such would be provided for by the same resources as the hiring of an employee.

Remember working capital?
You came across working capital requirement in module 2. This slide is just a refresher: working capital requirement designates the financial resources needed to cover your operating circle, that is what you need in order to cover the discrepancies between your operations and the actual cash in and out flows they generate.
Looking at your balance sheet, you can have an estimate of your working capital requirement at one specific time in year (that is, the end of your fiscal year): it represents your accounts receivable and inventory minus your accounts payable (setting aside the exceptional or financial payable and receivable).

Working capital requirement (WCR): an estimate
Planning to scale an enterprise, or trying to improve its cash position throughout the year?

In both cases, taking a closer look at your operating cash cycle and at the WCR it generates is quite recommended. Either to improve the existing or to provide for sufficient coverage if this is expected to grow.
Taking stock of your WCR and its evolution over the last year can be done by examining your past financial statements and observe WCR's evolution (remember, operational accounts receivable and inventory minus accounts payable) from one year to the next (say, over 3 years).
Has your activity been stable and you encounter a sudden rise in WCR? There might be some room for improvement either on your clients' side (does it have to be with your recovery process for instance?) or on your funders' side if you perceive grants in substantial proportion to sustain your social mission. Taking a look at the different elements of your WCR helps rapidly identify this. More to it in the part "Sources of finance".
In order to estimate the WCR of your enterprise in the years to come you can:

- Calculate line by line the ratio connecting the streams of cash registered over the year (in your past P&L) to the picture of current assets and liabilities it generates at one point in time (end of fiscal year, in your balance sheet), and their trend.
- Use these ratios to calculate a forecasted WCR at the end of each coming year, applying the ratio to the P&L projections.
- You can get a rougher approach to WCR estimate by calculating the days of sales it relates to in the past and applying it to the future yearly sales.
- Of course, this does not reflect what happens during the year. You need to refine the vision with your monthly cash flow statement in order to spot the highs and lows of your year, especially if your activity is seasonal.
- What if you are starting up a new activity and have no past performance to base your estimate on? Use average ratio (observed in your industry, or with certain clients' or suppliers' categories for instance) to apply to your P&L projections, and refine this appraisal with detailed operational cash flow projections (all the more so important if you are starting from scratch, meaning you have no working capital to provide for these needs and must see to it beforehand).

Investments – growing the enterprise's assets:
We previously touched upon investing cash flow cycle and how it reflects the medium-long term vision and sustainability of your social enterprise.
If a good appraisal of your core daily operations' financing needs is essential to ensure viability of your organisation overtime and have you focused on delivering its social impact while rolling out an enduring economic activity, long term vision is also instrumental in ensuring the relevance of your action overtime and the durability of the organisation striving to deliver a given social change.
Estimating your medium- and long-term investment needs, that will best serve your strategy, is therefore essential.
What are the tangible assets you would need to better serve your beneficiaries (new or improved premises, machinery or other equipment)?
What kind of intangible investment do you need to undertake: by pursuing research and development activity in order to develop new social innovations that would better tackle the challenges you want to take up?

Or are you looking into joining forces with other organisations, maybe taking stakes in these organisations or contemplating a vertical integration and a full fledge acquisition?
All these costs have a lasting impact on your structure and usually require external funding, as the only surplus generated by your operations over a few cycles cannot suffice.

Basic tools to support finance needs appraisal

Income statement: potential operating cash flows generated by your activity:

To complement this overview of finance needs, let‘s take a closer look at this financial statements we mentioned as tools to estimate what your enterprise needs now or might need in the future to run as smoothly as possible (when it comes to cash management that is !)

On this visual you can see the basic structure of a P&L account:

- on the left, the expenses and costs, on the right, the revenues that were incurred over a certain period of time
- operating costs and revenues are highlighted in yellow, financial in orange, „non-cash“ lines in green – these are items such as depreciation and amortization, which do not directly relate to any supplier or customer but are meant to represent the impact of time over the assets of your enterprise). Fiscal and non-recurring items also appear on this statement.

P&L statement represents the wealth created (or destroyed, in case of a loss) by the enterprise, that is all revenues minus expenses and costs incurred. Wealth created is different from the cash generated by the enterprise. Indeed, reading the P1L account do not give you any hint as to whether the customers you invoiced actually paid you, or whether you have already settled all the invoices received from your suppliers.

In other words, the P&L does not reflect the discrepancies generated by your operating cycle at the time you close your P&L.

To estimate the actual cash flow generated by your activity by the end of the period, financial, non-cash and non-recurring items set aside, you first need to carve out the part of the P&L that best reflect this „operating wealth“ generated, that is the EBITDA , as described in the upper right side of this slide.

You then need to imprint this potential wealth with impact of the operating cycle, that is the decrease or increase of your WCR over the last period.

This leaves you with actual operating cash flows generated by your activity, the central piece of your cash flow forecast.

A trend analysis over the past period as well as a benchmark with partners or competitors can help identify leverage for improvement of profitability and impact of the enterprise.

Make your P&L talk!

Balance sheet: what the enterprise owns, what it owes and what it is worth:

This financial document gives you a vision

- on the right-hand part of the slide, of what the enterprise owes (its liabilities, or seen from a different angle, what are the resources the enterprise uses in order to fund its activity)
- and on the left-hand side, what it owns (**its** Assets)

- it also tracks all the flows that are not directly seen in the income statement, by degree of liquidity (from the most liquid, on the top, to the less liquid, at the bottom)

- Inventories
- Accounts receivable
- Accounts payable
- Investments made
- Equity raised
- MLT debt

From Income statement and Balance sheet to cash flow statement & forecast:
In order for you to have a clear vision of your funding needs year on year over time, and design a financial strategy accordingly, you need to establish a cash flow forecast, which gives to see the actual movement in cash your enterprise does or is to encounter.
A cash flow statement or forecast if you are making projection combines data from your P&L (namely, operational cash flows) and from your Balance sheet (cash flows resulting from your investments and from financing them – loans and their reimbursements for instance), the bottom line being the net movement in cash of your enterprise since the previous period (usually year).

Translating investment into financial statements:
Let's practice in concrete terms how an investment translates into your financial statements.
A WISE in construction sector is acquiring new vehicles for 15k€ (net value) at the beginning of the year. The investment is to be amortized in full over 5 years.
How does this investment appear in the statements by the end of the year?

- In the Balance sheet the investment will appear as an increase in its assets, for 15 ke at the opening of the year
  - But being amortized over 5 years means that each year the facial value of the investment will decrease by 15k€ divided by 5, that is 3k€ per year.
- That means by the end of the year, only 15-3= 12 will remain as an increase in the assets, while a non cash movement of depreciation will reflect the movement of amortization on this asset, as an expense, in the P&L statement.
- The cash flow statement will register the investment as a negative cash flow from the investing activities of the enterprise, highlighting a potential funding need.

What is in a cash flow statement?
We mentioned a few slides before the purpose of the CF Statement and how it was built from the P&L and Balance sheet. This slide gives you a more detailed vision of what stands under the different cash flow categories (operating, investing, financing) that result in the appraisal of the net movement in cash of your enterprise over a period: the cash flows potentially generated by your activity (net income retreated from all non-cash items such as amortization) and the change in the working capital requirement it might have caused (a strong growth in turnover can mean a sudden increase of your WCR for instance), the cash movement created by your investments, the resources that were brought on

board to cover these needs (in the cash flow from financing activities' box) and also had to be repaid.

Financing plan- cash flow forecast

Deploying your cash flow statements for years to come equals designing a cash flow forecast. This forecast is central to identify your funding needs and define a relevant financing strategy, one that shall best fit the enterprise's needs. Highlighted in yellow are the cash flows potentially generated by your activity (net income retreated from all non-cash items such as amortization) on the one hand, and the repayment of debt on the other, as you shall see to it that your activity allows for your debt to be repaid over time. Avoiding too big discrepancies between the two after 2-3 years is essential, unless you are a start up with a very steep growth curve and equity investors with wide pockets able to fund your operating losses for a while.

What is to be seen …

This last slides just illustrates a few funding resources that are typically seen on a cash flow forecast and to be detailed in the upcoming session. It also lists a few indicators that are useful to keep in mind while designing your cash flow forecast, aka your financing strategy.

Sources of finance

Internal sources of finance

Retained earnings could be a useful source of funds by restricting the cash dividends distributed to shareholders, and possibly using a combination of cash and bonus shares instead. Shareholder may not be happy with reduced dividend income, and share prices may be affected negatively. However, since the market share price is the market's estimate of future earnings, the higher retained earnings would usually be reflected in higher profitability (through lower external funding costs) and a higher share price.

Businesses can implement a stricter credit control policy and manage the individual debtors' pending payments to reduce credit terms. This will have a positive impact on working capital through improved inward cashflows. However, selling goods and services on a cash-only basis / shorter credit terms and charging of interest on overdue balances would probably have a negative effect on sales and customer loyalty, resulting in disgruntled customers especially if competition allow better credit terms. Much also depends on the type of business – it may be acceptable for sales to persons to be in cash, but business to business transactions are unlikely to be on a cash basis. Furthermore, the firm's sales staff may be negatively affected by the new credit terms, and there may be legal and practical issues in charging interest on overdue balances.
The management of debtors could also be an Internal source of finance by negotiating longer credit terms with suppliers, thereby delaying payments to creditors which will positively affect cash flow. This could come against a commitment to purchase higher volume / payment frequency could improve credit terms. Also, improved relationship with suppliers as well as a positive bank reference may result in better credit terms. On the other hand, unauthorised delays may result in lower creditor confidence, and longer credit terms may result in lower credit limits and lower purchase volume. Competition may become more intense if suppliers seek alternative relationships with competitors.
Management of stock levels using 'just in time' strategies will result in better purchasing related cash flows, reducing the risk of aged / obsolete / expired stock situations. Lower stock levels reduce warehouse management costs / rental costs / stocktaking, security, and pilferage, but maintaining lower stock levels may result in lost sales due to out-of-stock situations. This could lead to lower customer (especially business to business) satisfaction and loyalty may be negatively affected. The process to reduce stock levels could result in discounts, and lower stock levels may reduce individual purchase volume and an increase in the purchase frequency, adding freight/transport/ administration costs.

External sources of finance

Existing shareholders may be enticed to increase their investment in the capital of the company, through the issue / purchase of equity or a shareholder's loan to the business. They may also support external financing options through the

provision of personal assets to be used as security, or to issue guarantees in favour of external lenders as security.
However, existing shareholders may not be willing to invest further, which may be seen as lack of confidence by external lenders. Furthermore, shareholders' loans are usually not looked at favourably by banks, and high debt to equity gearing may result in the perception of low risk sharing by owners.

Third party (new) investors may be enticed to invest in the business, against the sale of current or new equity, and such 'bullet' investment of equity capital would be useful since it does not have interest obligations and does not constitute debt. Depending on the jurisdiction, there are venture capitalists who specialise in the support of social enterprises and who have specific funds available to do so, and these venture capitalists / angel investors would probably insist on a controlling interest in the business. It should be noted that venture capitalists are not usually loyal in the long term, and may withdraw through liquidation of equity in the medium term depending on the market conditions. The role of the venture capitalist varies in different jurisdictions so care must be taken when seeking to attract such investment, even when the focus of the fund is supposed to be 'impact'.

There are various venture capitalist specialist firms who focus on social enterprises; these include:

Acumen Fund	https://www.acumenfund.org/
Calvert Impact Capital	https://www.calvertimpactcapital.org/
City Light Capital	https://citylight.vc/

Traditional bank overdraft facilities are useful to manage working capital requirements, enabling the business to manage cashflows in a flexible manner. This increased access to liquidity could result in discounts / better payment terms with suppliers / creditors. Bank overdraft facilities require tangible assets as security as well as other security (e.g., insurances), and the bank will often monitor the use of the overdraft account, as well as requiring regular updates on the business / account performance since businesses are often tempted to overtrade or use overdraft to finance capital requirements.

One may reduce lump sum capital outlays through the leasing of an asset (e.g., motor vehicles) over a fixed period of time. Leasing is effective since it usually includes maintenance and replacement in the case of vehicles and the lease fee is a tax-deductible expense, with the cash outflow being spread over life of the asset. Since it is a form of credit, balance sheet and depreciation charges are not affected. However, the leasing costs are usually more expensive than an outright purchase of the asset, and the leased asset is not owned by the business, requiring reliance on 3rd party provider of services

Outstanding debtor invoices can be 'cashed-in' by a factoring agent, and one can expect a 15% margin on the value of the invoice. This specialised service requires a fairly large volume of outstanding invoices and spread of debtors in order to be viable, but as a result, cashflow planning from debtors can be managed very effectively. Of course, there are fees as well as interest costs incurred, and low

volume and a low debtor base spread won't qualify for factoring. Debtors may be requested to confirm their debt by the factoring agent, and factoring debt could affect other bank lending availability / eligibility

Investment in fixed assets could be financed by bank medium to long term loans. b low interest rate environment could make loan term attractive since this is based on a margin over the bank base rate. Bank lending usually comes against a relatively small business contribution and the loan term duration and structure of repayment terms can be negotiated to some extent. However, since the effective bank lending rate is a function of the bank interest base rate, increases in the base rate could affect repayment obligations. Also, the term of bank loan is usually capped at 8 years (subject to jurisdiction) and loan repayments are usually regular monthly payments that include both capital and interest accrued. In this regard, future cashflows need to be regular in order to avoid default.

There a number of banks that support social enterprises:

https://www.abnamro.com/en/about-abn-amro/product/social-entrepreneurship-is-more-than-financial-profit

https://group.bnpparibas/en/news/supporting-social-entrepreneurs-accelerate-change

https://www.barclays.co.uk/business-banking/sectors/social-business/

https://finca.org/our-work/social-enterprise/

https://www.lloydsbank.com/banking-with-us/in-your-community/social-enterprise.html

Borrowing on the capital market through the issue of equity or corporate bonds could result in a long-term engagement by new investors. Both equity and bonds could be traded once listed, which could result in significant branding and credit rating benefits. The issue of equity requires no cashflow obligations except for the possible payment of dividends and being a listed organisation brings corporate governance benefits and higher efficiency levels due to market scrutiny. Having an external director contributes know-how and expertise at board level. The access to the capital markets comes at a relatively high cost through marketing, the prospectus, advisors, restructuring, as well as the potential risk of being fully subscribed. There is also the risk of negative market pressure on equity values. And 'external' shareholder issues such as the dilution of ownership/seeking dividend return not long-term growth. Compliance obligations and costs should not be underestimated, though it could be argued that these should be applied anyway.
The key advantage of a corporate bond is that it results in a lump sum receipt of funds, and if issued in a low interest rate environment, guarantees a low coupon for the life of bond. The successful access to the market could result in easier

future access as well as the possibility to roll-over the debt upon maturity. Interest paid on the bond is tax deductible, and there is no dilution of equity ownership. Furthermore, investors tend to like bonds which could come in various forms and structured bond conditions (e.g., vanilla, duration, callable). A corporate bond usually requires a strong cash flow as bond maturity approaches in order to finance repayment, and changes (increase) in the prevailing market interest rates could affect refinancing / rollover options.
One can access the lower-level capital market structures (e.g., Aim in London, Prospects MTF in Malta) that are aimed at smaller businesses, with a target capital to be raised as little as EUR5 million or even less. This relatively low-cost process still requires a business plan and a licenced intermediary in order to proceed to market.
Disclaimer : These sources of finance (public equity and debt) are not to be considered by social enterprises under many jurisdictions in Europe, when a regulated definition exists, as they are considered as privately held.

Crowdfunding relies on many small value investments made by many individuals and depending on the jurisdiction, the incentive to invest could be emotional (eg donation) or financial (e.g., purchase of equity). However, this is often a low-cost process that has vastly differing chances of success. It is often used for relatively small value capital requirements, and most (up to 75%) of crowdfunding campaigns do not reach their target. Crowdfunding tends to attract projects that are social, cultural, personal, and community-oriented in nature, but it is a relatively unregulated market and caution is advised.

Hybrid capital structures:

A recoverable Grant is a loan that must be paid back only if project reaches certain milestones. If the pre-determined milestones are not achieved, the recoverable grant is converted into a grant.
A forgivable loan is a loan which is converted into a grant in the case of project success, and if the social venture reaches the goals agreed to beforehand, the loan does not have to be repaid.
A convertible grant is a grant that is converted into equity in the case of success, whilst a revenue share agreement allows investors who finance a project to receive a share of future revenues, which is a form of risk sharing and gives social ventures some financial flexibility.

In line with the above, and depending on the jurisdiction, some jurisdictions offer aid to industry options to encourage foreign direct investment as well as investment in SMEs and family run businesses. Aid received through grants are not repayable whilst soft loans, longer term loans are subject to repayment. Some entities offer guarantees as security to support applications for bank finance since SMEs in particular often have inadequate security to be offered.
However, grants / aids to industry options differ from country to country and the application process can be daunting and time consuming. Tax compliance is often a condition to application and terms and conditions could apply, such as use of funds, personal guarantee from owners, compliance.

Financing strategy and how it impacts your enterprise

Financing: a virtuous cycle

This slide illustrates what a financial strategy is designed for: see to it that you have sufficient and adequate resources at your disposal to undertake the necessary investment that will grow your revenues or improve your profitability (or both), providing for sufficient resources to repay your debt (and/or remunerate your investors), that shall in turn allow your enterprise to access new external financial resources to invest more, etc.…

Financing: a vicious cycle

…whereas a poor financial strategy, such as insufficient fund raised or inadequate/oversized investment usually ends up in over indebtedness and if reinstalments do not succeed, in default.

What a balance sheet says …

This slide is a plain illustration of the previous 2 : on the left, end result (at one point in time, that is) of a sound financing strategy, on the right,

Master tool and end result of a financial strategy

Here are a few simple but essential steps to design a successful financing strategy:

I. **Know what you are looking for (**your development plan, the type of people/organisations you want to have around the table, the type of relationship (more or less engaged, for instance) you are looking for)
II. **Analyze and estimate the funding need**
III. **Know the funding solutions and tools**
IV. **Identify the best suited partner to maximize social impact**

A few remarks (1)

- Regarding the estimation of your funding needs be sure to not overlook the appraisal of the upcoming changes in your WCR, as well as to integrate recurring investments necessary to maintain the current operating tools (“recurring capex”), when it comes to investment.

- Do not lose the azimuth of your financial strategy: its purpose is to preserve/consolidate the financial structure of your enterprise, as well as allowing sufficient room for maneuver in case the unexpected happens.

- Keep in mind that your cash flow forecast does not integrate short term movements. Short term funding needs have to be evaluated as well (and a funding solution identified in order for the business not to have to put up with this issue
    - This is obviously very true for seasonal activities

- It is useful to identify the roots of potential cash flows issues: structural (very often linked with insufficient long-term resources at the beginning) or just at a point in time. As the 1st one is to be covered by medium-long term funding, short term solution is adequate to provide in the 2nd case.

- This might lead you to reconsider your medium-long term financing strategy.

A few remarks (2)
Your cash flow forecast is, as we mentioned earlier, a master tool of your financing strategy. This is very true from design to roll out of your strategy: your cash flow forecast will be your negotiation as well as piloting tool.

- Negotiation as it helps giving to see:
    - What is to be funded;
    - An overall understanding of the funding needs for the business,

- Piloting, as it allows to:
    - Visualize the dynamics of your growth /financing strategy
    - Conduct a relevance check of BP hypothesis
        - In terms of net income and changes in working capital generated
        - In terms of production means, investments considered
        - In terms of constraints linked with funding strategy considered. (While highlighting for instance the match between operating cash flows and debt repayment required)

A few concluding comments
We would like to leave you with a few concluding comments related to financing.

- When considering a development project, in general, take a good look at the changes in working capital requirements: this will help anticipate any change in WCR and avoid potential cash shortage crisis:
    - although there are ways to partially fund WCR (additionally to quasi equity funding), which have been described in the previous section of this module (Overdraft facility, Short term credit), it is recommended to be watchful of an over mobilization of these types of funding as they generate High financial charges, and remain uncertain in the long run.

- Related to the appraisal of an investment project:
    - be sure to check its adequacy with your strategic roadmap (impact and economic wise). This will be in any case challenged by your potential funders.
    - Benchmark investment costs to ensure you pay the fair price,
    - and ensure the consistency of your financing plan with the current financial structure of the enterprise (in terms of debt and equity, 1st

of all) as well as with your current yearly operating cash flows /projections

- Unless plethoric cash position, avoid self-funding, your reserves are best to keep for rainy days as well as to leverage future funding.

Reflection / Self-Assessment

1) How would you evaluate the current financial strategy of your enterprise? Are the financial needs sufficiently covered? Do you think you have the right pool of financing partners at the table for the project?

2) How would you ensure you have a good appraisal of your financing needs, currently and in order to best support future development steps you are willing to take?

3) What would be the first steps you would be willing to take in order to improve the financing of your social enterprise?

Further Resources

To be filled out

Tips to the trainer (optional)

To be filled out

References

To be filled out