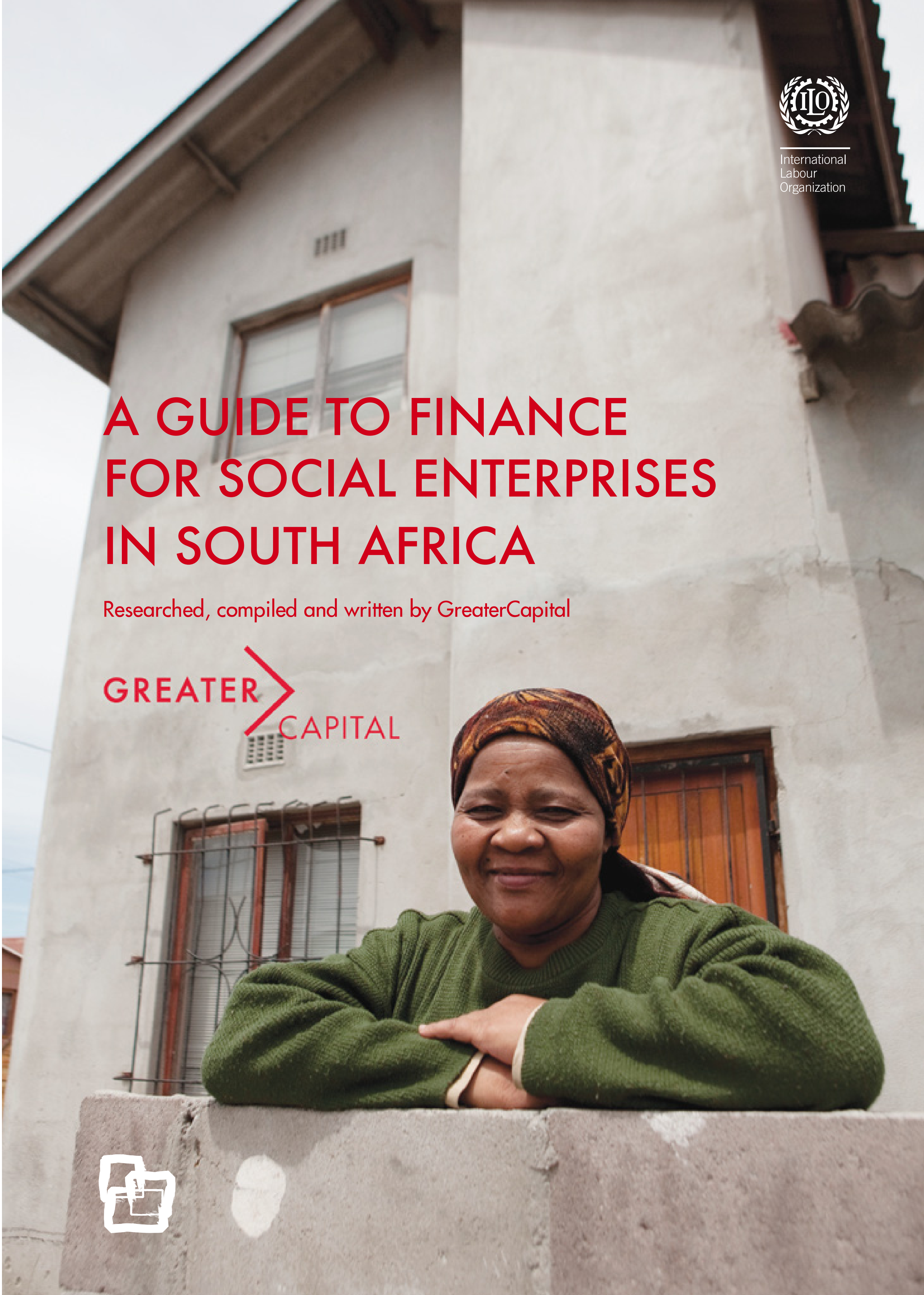

International Labour Organization

A GUIDE TO FINANCE FOR SOCIAL ENTERPRISES IN SOUTH AFRICA

Researched, compiled and written by GreaterCapital

GREATER CAPITAL

A guide to finance for Social Enterprises in South Africa.

ISBN
978-92-2-124609-1 (print)
978-92-2-124610-7 (web pdf)

ILO Cataloguing in Publication Data

On the cover: Virginia Phumza Mbendeni, a client of The Kuyasa Fund which provides micro finance to low income South Africans. Photograph by Sam Reinders for GreaterCapital.

Printed in South Africa

A GUIDE TO FINANCE FOR SOCIAL ENTERPRISES IN SOUTH AFRICA

Researched, compiled and written by GreaterCapital

International
Labour
Organization

HOW THIS GUIDE WAS MADE

The Guide to Finance for Social Enterprises is a collaborative effort between GreaterCapital, a subsidiary of the GreaterGood group, and the International Labour Organization (ILO). GreaterCapital is a social enterprise providing strategic impact investment advice that seeks to link sustainable, impactful organizations to capital, and to maximise the positive effect that they have on their beneficiaries. The ILO is the tripartite UN agency that brings together governments, employers and workers of its member states in common action to promote decent work throughout the world.

This guide sought to tailor its contents to the specific needs and unique circumstances of the South African social enterprise sector. As such, it began with a survey that was sent out to all of the members of Greater Good and GreaterCapital's database. This includes all projects that are listed on the South African Social Investment Exchange, and all members of the African Social Entepreneurs Network (ASEN). The survey, which yielded 55 responses, allowed enterprises to indicate which elements of a guide they would find most useful, and which pieces of information about potential funders ought to be included in a database. This allowed us to target the content of the guide at real information gaps in the industry. The survey also asked enterprises to list their own sources of funding, as well as any crucial financial advice or information that they felt was worth sharing. This enabled us to fill out the database and buttress the advice component of the guide with content from real South African social enterprises. A live web-chat hosted by the African Social Entrepreneurs Network (ASEN) on September 22, 2010 allowed entrepreneurs and other industry players to ask questions and give their input on the desired features of a guide.

The counterpoint to this needs-assessment for enterprises was a schedule of interviews with key intermediaries and funders. This was used to determine what they believed social enterprises could use in a guide, to further map the funding ecosystem in South Africa, and to refine our target audience.

The next stage of research involved reviewing existing international examples of guides and advice on social finance, as well as the internal expertise of the GreaterCapital team, and crafting an advice section that included the components from these sources that were relevant to the South African context. Simultaneously, desk research helped fill out the database with the entries for finance providers in the database. Case studies were drawn from survey respondents and GreaterCapital's network. Following an internal peer review and an external data verification process, the guide was completed.

ACKNOWLEDGEMENTS

Contributors

Amy Tekié
University of Pretoria, Gordon's Institute of Business Science, Certificate Programme for Social Entrepreneurs

Ansulie Cooper
Monitor Group

Daniel Hatfield
EDGE Growth

Errol Gardner
Khula Enterprise Finance Ltd.

Francois Bonnici
Schwab Foundation for Social Entrepreneurship

Gabriel Simoes
Relativ Enterprise Development

Jeanne Rose
African Social Entrepreneurs Network

Kathy Watters
UnLtd South Africa

Lillian Masebenza
Mhani Gingi Social Entrepreneurial Networks

Pascal Froelicher
Heart Social Investments

Research, Evaluation and Due Diligence Team
GreaterCapital

Tamzin Ractliffe
NeXii Global

Case Studies

Big Issue South Africa

Books of Hope

Bulungula Incubator

Phakamani Foundation

Shonaquip

Silulo Ulutho Technologies

Small Enterprise Foundation

Township Non-Profit / Afrique du Sud, Bidonvilles

Writer

Jack Breslauer, GreaterCapital

Editor

Vicki Edwards

Funders

Government of Flanders

Cadiz Asset Management

NOAH Financial Innovation

FOREWORD

The global economic crisis and its aftermath deepen the challenge of decent employment creation. The Global Jobs Pact developed in response to the crisis sets out a framework that ensures linkages between social progress and economic development.

In this context, there is increasing interest in the social economy as a way to combine social and economic goals. The Ouagadougou Symposium on the Global Jobs Pact as it relates to Africa included a recommendation to increase support to the social economy. A regional conference in October 2009 on the social economy as a response to the economic crisis in Africa defined the social economy as "a concept designating enterprises and organizations, in particular cooperatives, mutual benefit societies, associations, foundations and social enterprises, which have the specific feature of producing goods, services and knowledge while pursuing both economic and social aims and fostering solidarity."

Interest in the social economy is increasing in South Africa. By signing the Decent Work Country Programme for South Africa in September 2010, the ILO's constituents noted that "SMMEs such as group cooperative enterprises and social businesses which are components of the social economy have been identified by the social partners as one of a variety of viable and sustainable economic enterprises that can help to alleviate pressure on the local labour market." They therefore called for "support for the upgrading and promotion of Social Economy enterprises". The developmental growth path announced by the Government of South Africa in October 2010 identifies the social economy as one of ten key 'jobs drivers'.

Against this background, new forms of social purpose businesses are emerging. Community-based organizations are recognizing the need to generate sustainable income streams to fund their social purpose, to reduce their dependence on grants and donations. Social entrepreneurs are setting up enterprises that are run like businesses but that exist for a social purpose rather than private benefit. Just like any business, they need access to finance to fund their operations and growth.

But these social enterprises often fall between the cracks, being neither traditional non-profit organizations nor conventional businesses, and find it hard to access appropriate financial services as a result. In many cases they don't understand the different kinds of finance available, or where to find appropriate financiers.

It is therefore my pleasure to welcome you to this guide to finance for social enterprises in South Africa. The guide has been developed as part of a series of publications that seek to help our constituents and stakeholders to promote social economy enterprise development in South Africa.

We are grateful to GreaterCapital, who researched and wrote the guide, and to Cadiz Asset Management and Noah Financial Innovation, who co-sponsored this publication.

Vic van Vuuren
Director
ILO Office for South Africa, Botswana, Lesotho, Namibia and Swaziland

TABLE OF CONTENTS

1. Introduction **8**

2. What kind of enterprise are you? **10**

a. Does this guide apply to you? 10
- Are you a social enterprise?
- What size are you?
- Are you a new business?

b. Classifications and funding options 12
- Legal incorporations
- Hybrid models and their manifestations
- BBBEE: Eligibility opens doors

c. The targeting of finance in South Africa 17

3. Should you be looking for outside finance? **18**

a. Don't look for finance until: 18
- You are confident in your enterprise
- You have exhausted local options
- You are run as leanly as possible
- The numbers add up

b. What you will need before applying for finance 22
- What are the origins of your enterprise?
- What are your financial requirements?
- What are your social requirements?

c. Combining the financial and the social: the social enterprise business plan 27

4. What type of finance should you be looking for? **28**

a. Types of finance 28
- Grants
- Debt
- Equity
- Patient capital

b. Financial Instruments 33

- Grant instruments
- Debt instruments
  - Short term
  - Medium term
  - Long term
- Equity instruments
  - Share issue
  - Private equity
  - Venture capital
- Mixed instruments
  - Mezzanine finance
  - Quasi-equity

c. Different instruments for different needs 37

d. Different finance types for different stages of organizational development 38

5. Who offers finance? 40

a. What types of finance provider are there in South Africa? 43

b. What returns are expected by different finance providers? 43

6. How to position yourself for successful financing 44

a. Using your network 44

b. What do finance providers look for? 46

c. How do finance providers make their decisions? 47

d. After due diligence 49

7. Glossary, bibliography and resources 52

1. INTRODUCTION

WELCOME

South Africa is a nation with daunting challenges but amazing potential. While government and the traditional non-profit sector can work towards reducing the prevalence of crime, unemployment, low quality education, poverty and HIV/AIDS, the enormous scale of these problems means that these efforts will not be enough.

The conventional private sector can also play a role, by generating income and providing tax revenue as well as through corporate social investment. But the enormous challenges we face also call for new approaches that directly apply an entrepreneurial approach to tackling social problems. Around the country, in addition to generating an income for themselves, entrepreneurs are establishing businesses that educate children, improve HIV awareness, protect endangered species and build affordable housing (to name just a few). Such businesses are what we call 'social enterprises'. They are attracting increasing attention, from funders and policy-makers alike, by providing sustainable, market-based solutions to social problems.

These social entrepreneurs often struggle to grow their business from an idea, to a small model that works, to a scaled operation that empowers large numbers of people. Some lack the skills, experience and expertise required to succeed in business. Some lack the roads, fibre-optic cables and transportation networks to reach their markets. Others struggle to sell their services to consumers who are recovering from a recession. This guide will not solve any of these problems. However, some entrepreneurs understand their business, have a healthy demand for the product they are selling, and a capable team around them. The only thing they lack is the financial support to take their business to the next level. If this describes your business, this guide is for you.

The *Guide to Finance for Social Enterprises* is designed to take you through the entire process of financing your business, starting with identifying your needs and ending with how to ensure that they are met in the cheapest and most sustainable way.

The guide has five stages, which we believe reflect the thought progression that any social business looking for finance should also go through to make the search as quick, efficient and fruitful as possible.

The first stage is basic but crucial. It involves understanding exactly what your business is. Successfully applying for finance almost always involves packaging your organization in a way that '"ticks all the boxes'" in a provider's list of funding criteria. Some will want a black owned section-21 in Kwa-Zulu Natal that works in rural areas.

Others will want a high growth opportunity in the high-tech sector offering above-market returns. These two providers could be financing the same organization! However, the organization would have to present itself very differently to each of these two possible providers.

Once you know what your business is, you must ask two fundamental questions: "Do I really need finance?" and "Am I ready for finance?" All finance will have strings attached that may change the direction of your organization or impede its future growth with burdensome repayments. Looking for finance is in itself costly and time consuming, so it is important that before starting the search, your organization is confident that it stands a reasonable chance of successfully obtaining it, and is ready and willing to make full use of it.

When we get to the fourth section you will understand the nature of your organization and its financing needs. This section will describe the different financing options that might address these needs. In the modern financial system there is a bewildering range of grant, debt and equity instruments that an organization could use, so it is crucial to understand how these all work before deciding which is the most appropriate. Section four also explains the advantages and disadvantages of each major type of financing, so that organizations that have always sought only one type can understand the potential benefits (and risks) of diversifying into others.

The fifth section, an online database at www.saiin.co.za/financeproviders, enables you to apply the knowledge you have built up about your business characteristics and financing needs by providing a list of the types of providers of finance in South Africa. This section complements the comprehensive database of providers which accompanies this guide. While the database does not include every source of finance available to every South African business, it includes all providers with whom successful social enterprises we have interacted with have found funding. The database includes information on what each provider is looking for and how the application process works. Using this information you can tailor your 'pitch' to the specific criteria that they might have.

While the guide is intended to provide a solid foundation to any finance-seeking social enterprise, it will inevitably not answer every question that you may have. Many sources of finance are available to very specific sectors and societal groups, and the list of providers is growing and changing all the time. Section six will explain how to find additional help in planning for and securing finance. It includes links to organizations that help with business management and fundraising, documents and resources that provide more detailed information around business plan development and financial planning, and tips on how to make the best use of your network to support your business growth.

2. WHAT KIND OF ENTERPRISE ARE YOU?

This section is designed to enable you to locate your business within the classifications that finance providers use when making funding decisions.

Although these characteristics may be obvious to you as someone intimately involved in the organization, funders will often want, for example, an emphasis on or proof of social enterprise status or black ownership. Understanding which categories your organization fits into will also help you navigate to the areas of this guide that are most relevant to you.

This section will:

- Explain our working definition of a social enterprise
- Describe the targeting of this guide in terms of the size and age of the enterprise
- Show how legal incorporations and BBBEE eligibility can affect your finance options
- Depict the way that finance tends to be targeted in South Africa

Does this guide apply to you?

Are you a social enterprise?

This guide is specifically designed to help social enterprises. It is not primarily intended for use by pure for-profit organizations, which exist solely to generate profits and expand, or for pure non-profit organizations, which rely entirely on grants, subsidies and donations for survival.

There are myriad definitions of what a social enterprise is, as well as a multiplicity of terms that sometimes refer to the same thing, including impact investment, double or triple bottom line businesses, social purpose business and hybrid business.

Whether or not you consider your own organization a social enterprise, you are considered as one by this guide (and it is therefore useful to you) if:

- The primary purpose of your enterprise is to address a social or environmental issue. [1]

and

- You produce a good or service to sell to the market. [2]

This is a rather broad definition, but it does contain the two elements that we consider crucial to identifying a social enterprise viz. **a social purpose** and a **market orientation.**

A note on terminology

This guide will normally use the word 'enterprise' to describe the social enterprises that are the subject of the material. It will refer to the revenue generating side of the enterprise as the 'business', and sometimes refers to the overall entity, including welfare-providing elements, as the 'organization'.

Other organizations, including many providers of finance, will have their own, often more stringent, definitions of what constitutes a social enterprise, and it is important to check with each provider to ensure that your organization falls within their parameters.

We are not specifically excluding companies that do not reinvest all of their profits directly back into the business. We believe that in some cases the distribution of profits can further an organization's social purpose, particularly when the recipients of profits are themselves social enterprises or non-profits. Issuing dividends to shareholders or bonuses to directors will prohibit your enterprise from being classified as a Public-Benefit Organization and as a non-profit.

This will cut off many sources of grants and patient debt funding and will prevent it from securing any related tax advantages. Thus true social enterprises rarely adopt a model where profits are not primarily re-invested.

This guide is NOT for:

- Non-profit organizations that exclusively provide a service or good to disadvantaged groups for free and then seek grant funding from the government and external donors, while having no operations that generate their own revenue.
- Traditional for-profits whose primary aim is to grow and provide value to shareholders. Although you provide employment, help to build infrastructure or indirectly achieve other valuable social or environmental outcomes, it is only those organizations whose primary purpose is to achieve these outcomes that are considered to be social enterprises.

While the content of this guide is broad-ranging, and may thus apply partially to all of these groups, it is not intended for them, and may thus not always provide relevant advice or information. It can, however, provide a useful reference for businesses or non-profits looking to move in the direction of social enterprise. This guide can help these organizations identify the financial and social requirements needed to make the switch, as well as the funding sources that such a transition may unlock.

What size are you?

Social enterprises can range from a street vendor selling healthy produce in underserved communities to an international organization providing housing finance to millions of people. This guide cannot provide meaningful information to the entire spectrum, since the financial expertise and requirements for businesses of different sizes vary enormously. We have thus designed the guide to be used by small and medium sized enterprises. These enterprises will usually have a turnover of between R1 million and R10 million. They will have managers with some financial sophistication and internet access, but will not necessarily have access to specialist financial advisors and fundraisers. We have identified this group as most likely to benefit from the information contained in this guide, so if your business falls into this category, this guide is for you!

Larger businesses may still find much useful information in this guide, as many private equity firms and Development Finance Institutions (DFIs) also cater to larger operations. Smaller businesses could also use this information in their longer term planning, but are advised to seek finance from their local networks, or from one of the microfinance institutions listed in the database, as the administrative requirements and associated costs involved in searching for finance may be prohibitively high.

Are you a new business?

This guide is targeted at businesses that are established, and have managed to generate substantial revenues (and ideally profits) from the sale of goods and services. If you have an idea for a business and want to start one, this guide may be of help to you. A word of warning however: obtaining finance for a business that has no proven track record is extremely difficult. Funders will want substantial evidence of the success of your management team in similar areas, and will often demand substantial collateral. Only the most outstanding ideas can be funded before they begin operation. Many social enterprises have advised new entrepreneurs to get their business up and running, using locally available resources and with as little finance as possible, until they are in a position to demonstrate its success to potential funders. For guidance as to whether you should start your own business, refer to the SEDA website link in section 7.

[1] While we do not seek to determine what constitutes a 'worthy' social or environmental issue, it is worth stating that in our opinion 'generating economic growth' or 'providing employment' are not in themselves social purposes. By contrast, employing members of historically underprivileged groups who were previously long-term unemployed, does constitute a social purpose in our view, as long as this is done in a sustainable way.

[2] While many social enterprises have non market-based activities that rely on grant funding or subsidies from the profit-generating business, all social enterprises must have at least one revenue generating product that they sell to the market to generate a meaningful amount of their operating budget

Classification and funding options

As a social enterprise, there are some sources of funding that will be uniquely available to you. However, in South Africa, there is relatively little funding that specifically targets social enterprises.

This is partly because South Africa has no legal definition of 'social enterprise' that organizations are able to use as a form of incorporation (such as the Community Interest Company in the UK or the L3C in the USA). Thus, in addition to these sources, you will want to seek finance based on the other characteristics of your organization. Your legal status is most important as it reflects crucial aspects of how your organization is run and funded, but other factors will also affect the avenues for funding that you might pursue.

Legal incorporations

As a social enterprise, your legal incorporation will determine your tax liability, your financial reporting requirements, and, most relevantly, the types of finance that are available to you. Although it is complicated, organizations can change their legal incorporation in order to move in different directions, or to spin off certain functions to new entities with a different legal structure (see 'Hybrid models' below).

The 2008 Companies Act (due to come into force in April 2011) slimmed down the number of legal incorporations. The most important change is now the simple separation of non-profit and for-profit companies, with the elimination of previous sub-divisions. The Act does not apply retroactively however, meaning that existing subdivisions will still apply to companies unless they choose to change them. The new categories will apply to all new incorporations.

For-profit companies

The vast majority of businesses with which you interact to buy goods and services are for-profit companies. These include:

- Proprietary (Pty) Limited and Public Limited Companies
- Close Corporations
- Sole Proprietors
- Co-operatives

For-profits have relatively few restrictions on their finance options. However, many foundations and grant-issuers will explicitly limit the eligibility of their grants to non-profit companies or will only fund for-profit companies where that funding supports enterprise development as defined by BBBEE legislation. For more on this see the section on BBBEE below. In addition, Public Benefit Organization (PBO) status, which exempts the organization from taxes on donations made to it, is not given to for-profits. Section 18a status, which makes donations to the organization tax free to the donor, is also not given to for-profits. These tax exemptions can help an organization stretch its income streams, and in the case of 18a status they can actively encourage donations and grants. Sole proprietors are also not allowed to take out business loans, since the business is not a separate legal entity, and must thus rely on personal loans for finance. Each type of for-profit entity has differing rules surrounding membership, shareholder liability and auditing requirements.

Non-profit companies

Most non-governmental providers of social services are non-profit organizations. These include:

- Section 21 Companies
- Voluntary Associations
- Trusts

A common misperception about non-profits is that they are not permitted to make profits at all. In fact, non-profits can (and in the case of social enterprises, should) make profits, but are merely prohibited from distributing these profits to directors or shareholders. Instead, profits must be entirely re-invested into the organization, where they can be used to ensure sustainability over the long-term by building up reserves. Non-profits enjoy societal recognition for the work that they do, which can make it

Legal Incorporations and their Consequences	For-Profit	Non-Profits
Can sell goods and services	Yes	Yes
Can receive grants	Often ineligible	Yes
Can take out debt	Yes	Yes (often self-limited)
Can issue equity	Yes	No
Can receive tax exempt status	No	Yes
Can receive donor tax exempt status (section 18.a)	No	Yes
Can make profits	Yes	Yes
Can distribute profits to directors and/or shareholders	Yes	No

Table 2.1 - Legal Incorporations and their Consequences

easier to attract grant funding and donations. Non-profits can also apply for PBO or Section 18a status which, if granted, will provide a tax advantage to the organization (and in the case of Section 18a, its donors). Many grants and much government spending are reserved specifically for non-profits.

As a social enterprise, being registered as a non-profit also has some limitations. Firstly, while non-profits can take out debt, in the case of Section 21 companies the directors bear unlimited responsibility for the debt. This means that the director's assets are at risk if the company cannot pay off the debt. Many non-profits therefore have a provision written into their constitution not to take on debt. Non-profits may also not issue equity. This rules out investment from venture capital and private equity. Both of these limitations can be mitigated, to an extent, through the use of hybrid organizations.

For a more detailed discussion on legal forms and their relevance to social enterprise, please refer to the ILO Guide to Legal Forms for Social Enterprise.

Hybrid business models and their legal manifestations

Many social enterprises operate so-called 'hybrid models' (also known as dual models), meaning that they solicit grants and donations while simultaneously generating revenue from the sale of a good or service. The percentage of overall revenue gained from the sale of goods and services ranges widely, and will generally be higher if the social enterprise started as a for-profit business that adjusted to focus on a social motive than if it started as a pure non-profit that developed a revenue-generating arm for added stability.

In the South African funding environment, finance tends to be directed towards either non-profit organizations that are grant-dependent, or on businesses that are expected to generate profit and reward the financier with interest or dividends. If you operate a hybrid model, it may be worth formally splitting your business in order to be eligible for both types of funding.

A single entity cannot simultaneously be a non-profit and a for-profit. While one organization can have a non-profit and a for-profit component, there are strict guidelines surrounding how these two must interact. This interaction may not exploit grant funding or tax advantages. In most split businesses there is a non-profit of some sort operating alongside a for-profit. There are three ways to transfer money between the two entities, and a given enterprise may employ any number of these methods, or none of them:

1. One company can hire the other's services at market rates. This could include staff time, physical products, or research and intellectual property. Often the for-profit will pay the non-profit for the research, designs or software that allows it to produce the product that it sells to the market.
2. The for-profit can donate money to the non-profit. This donation is subject to donations' tax on both sides however, unless the non-profit is a PBO and a Section 18a company.

BULUNGULA LODGE AND INCUBATOR

A symbiotic relationship between non-profit and for-profit

Background

Bulungula lodge is an ethical tourism destination on the Wild Coast of South Africa. Established in 2004, it is 40% owned by the local villagers and adheres to strong environmental and socially ethical principles in its operations. From its inception, the lodge aimed to fuel the local economy with tourist money, and in 2007 formalized this effort with the creation of the Bulungula Incubator, a non-profit association that develops local micro-businesses such as horse-riding and canoeing to cater to tourists. It has since added other programs around education, nutrition and health.

Financing history

The Bulungula lodge was started using founder David Martin's personal savings, and has subsequently been sustained using self-generated revenues, making a small yearly profit which is re-invested. It also benefitted from a Department of Trade and Industry (DTI) program, the Small and Medium Enterprise Development Program, which offered a 30% rebate on any investments made into the business over a 3 year period (note that this program is no longer offered, but that similar programs are offered by the DTI on a sector-specific basis). The incubator, on the other hand, has received substantial external support from grant-making organizations. It has received grants from corporate foundations, including Deutsche Bank, Old Mutual and the DG Murray Trust among others.

Relationship between for-profit lodge and non-profit incubator

The incubator and lodge do not fund each other's activities, and in that sense are quite financially distinct entities. However, through their operations they have a powerfully mutually supportive relationship. Visitors to the lodge provide much of the custom to the micro-enterprises that belong to the incubator, and also frequently donate to the incubator program. Conversely, potential donors and other visitors to the incubator will stay at the lodge, increasing its guest numbers. So while there is no sharing of funding between the two organizations, there is considerable sharing of markets and infrastructure.

KEY TAKEAWAYS

- Hybrid organizations can assist each other in more ways than the simple transfer of funds.
- Having a for-profit and non-profit working side by side to develop a community can offer both the access to grant funding that non-profits enjoy while and the stability and sustainability that for-profits bring.

3. The non-profit can own a shareholding in the for-profit. It can then earn money from dividends issued by the for-profit, or by selling its shares to other investors.

Split models must be careful to respect the spirit of the law. Money cannot be siphoned into the for-profit to be issued as dividends to directors and shareholders. Similarly, companies cannot divert funds from the wealthier to the less wealthy organization in order to fall below the VAT threshold for both (known as 'round-tripping'). Legal advice should be sought to help your organization determine whether a split model would be beneficial.

BBBEE: Eligibility opens doors

South Africa's Broad-Based Black Economic Empowerment (BBBEE) programme gives preferential treatment in government procurement to companies who are seen to empower black people and other previously disadvantaged groups, or who themselves hire companies that empower these groups. There are seven criteria that contribute to an organization's BBBEE rating, and fulfilling two of them may qualify your enterprise for special funding sources. Companies can earn points for Enterprise Development (ED) where they assist Black-owned and -operated businesses with technical and/or financial support (including grants, loans, equity and in-kind donations), and Socio-Economic Development (SED), where companies help to bring 'sustainable economic inclusion' to previously disadvantaged groups (through grants or in-kind donations).

Corporations can use their Corporate Social Investment (CSI) budgets on projects that will earn them SED points to help improve their BBBEE compliance. As a social enterprise it may help your finance prospects if you are classified as a legitimate recipient of SED funding. Overall, ED budgets are three times the size of SED budgets in South Africa, so qualifying as a legitimate destination of ED funding is a major, and uniquely South African, opportunity to get finance for your social enterprise on preferential terms. In addition to corporations, many domestic, and some international DFIs, prioritise black ownership or the empowerment of previously disadvantaged groups when making funding decisions.

There are two classes of enterprise that qualify for ED spending:

- Category A companies deliver 25% extra BBBEE points and are thus particularly appealing. These enterprises have at least 50% black ownership and a turnover of less than R35million.
- Category B enterprises still qualify for BBBEE funding at the regular rate. These enterprises can be of any size, but must either have over 50% black ownership or over 25% black ownership plus have a BBBEE rating of between 1 and 6.

> To be qualified as 'Black' under BBBEE you must be of Black, Coloured, Chinese or Indian descent, and a citizen and resident of South Africa either since birth or from at least 5 years before the introduction of the interim constitution in 1993.

Note that non-profits do not qualify as enterprises and cannot receive ED funding directly. They can, however, receive such funding if they are helping to develop enterprises. This is the case in many micro-finance or incubator-based social enterprises (see Case study 7: Township Non-Profit in Section 6).

To qualify for socio-economic development points, the beneficiaries of the company's SED spending must be at least 75% black. Financers looking to gain SED points from financing your company will therefore look for a similar ratio, and ask for written confirmation of the ethnic make-up of your beneficiaries.

Some sectors (Construction, Tourism and Mining) have their own BBBEE charters, with slightly different regulations. If you are operating in one of these sectors, it is worth studying the charter to determine the eligibility of your organization and the opportunities it might offer you.

In the South African context, it is essential to know your ED and SED eligibility, and, if eligible, how to target finance providers who are looking for qualifying organizations, as this is one of the largest sources of soft loans, grants and technical assistance to social enterprises in South Africa.

SILULO ULUTHO TECHNOLOGIES

Accessing Enterprise Development spend

Background

Started in 2004 by Luvoyo Rani and his brother Lanwoyo, Silulo is a technology services provider which caters to township residents of the Western Cape. It provides IT training, hardware skills and maintenance and support services, and also operates 16 internet cafes.

Financing history

For the first four years of its existence, Silulo lived virtually hand-to-mouth. It began by offering a pooled finance mechanism for six residents of Khayelitsha to purchase their own computers. Each would contribute R 400 per month and the program would purchase them equipment, one by one. As the program attracted more participants and recognition, the Ranis recognized a significant untapped market for IT in the townships. In 2006 they started their first internet café, leasing their computers and internet connectivity from their supplier and using community members to help build and install tables and other furniture. By 2008 Silulo had the network and exposure to allow it to seek grant and enterprise development funding, and since then it has expanded rapidly. It still generates a substantial proportion of its own revenue, having paid for the opening of six out of sixteen cafes with its own funds.

Technical Assistance

Relativ Enterprise Development has assisted Silulo with financial planning and relationship management, helping them secure in-kind donations from the likes of Microsoft, Apple and Dell. It also connected them with an international source of finance – Transformational Business Networks (TBN), who provided them with a R500 000 loan with a below-market interest rate of 7.5%.

Enterprise Development Funding

Over the past two years, Silulo has accessed some of the significant enterprise development spending that is available to small and medium social businesses with Black ownership. Its two main ED sponsors are M-Web, who gave them a R416 000 grant to buy stock and open training centres, and Vodacom, who paid for the equipping and refurbishment of a training centre and an internet café. They also entered the SAB Kickstart Enterprise Development competition, winning a regional prize of R110 000 in 2008 and a national prize of R150 000 in 2009. This funding has allowed Silulo to continue offering subsidized training services to underprivileged populations while expanding their core retail and internet café business at a rapid rate.

KEY TAKEAWAYS

- Grassroots social entrepreneurs without established networks or large personal funding sources can successfully access finance and take their idea to scale, through a combination of an innovative product that fills a gap in the market and sound management and financial planning.
- Enterprise development spend is a uniquely South Africa opportunity for black-owned businesses to access preferential finance.
- Intermediaries such as Relativ may help promising ventures grow their expertise and connect with potential sources of finance.

The targeting of finance in South Africa

This diagram shows the groups to which providers of finance tend to target their offerings in South Africa. It shows that there may be significant overlap among the categories, but that positioning oneself as a distinct small or medium enterprise (SMME), for example, may allow access to specific types of funding that would not otherwise be available. Therefore, in the current environment, social enterprises must often behave as 'chameleons', changing the way they define themselves according to the type of organization for which the finance is designed.

The database which accompanies this guide divides finance providers into the categories listed on the right-hand side of Figure 2.2 below. Understanding where your enterprise is positioned (as a social enterprise, non-profit, SMME or for-profit) will help direct you to the categories in the database that are likely to be most relevant to you.

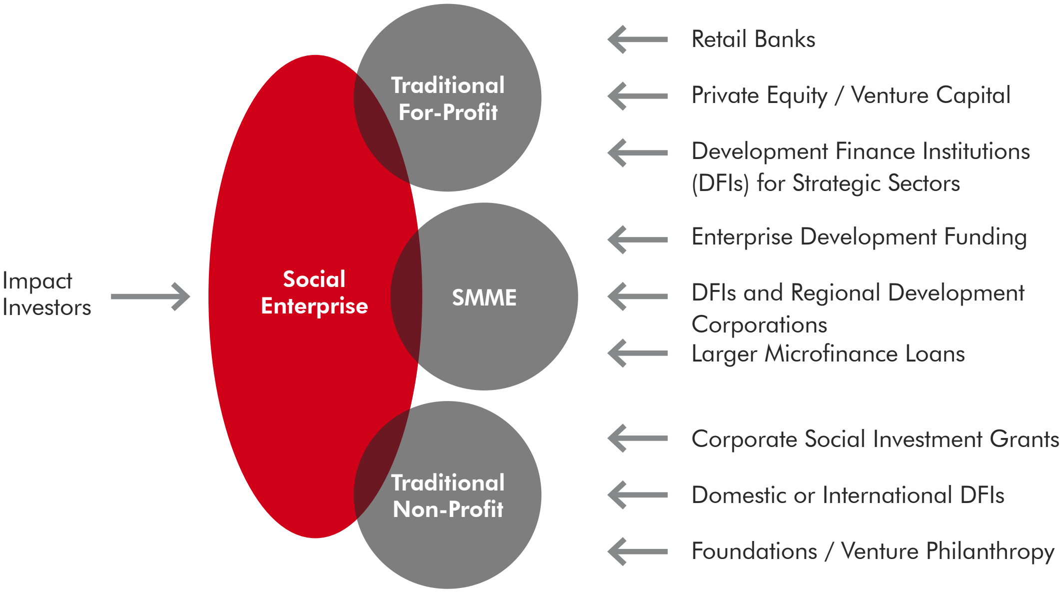

Figure 2.2: Targeting of finance in South Africa

3. SHOULD YOU BE LOOKING FOR OUTSIDE FINANCE?

Investors, intermediaries and enterprises all emphasise that a conservative attitude should be adopted when seeking finance, especially given the particular constraints of the South African business environment.

This section will allow you to assess your own readiness for finance and prepare the necessary materials.

It covers:

- The requirements we think every business must meet before applying for finance
- Financial requirements for applying for funding
- Social requirements demanded by grant funders and impact investors
- Explanation of the social enterprise business plan

Don't look for finance until:

You are confident in your business

South Africa has one of the highest rates of failure for new business start-ups in the world. This is mainly because many businesses are started by unemployed individuals as a means of earning money. These 'survivalist' enterprises often lack the business acumen, crucial competitive advantage and niche markets that lead to the success of 'opportunistic' enterprises.

Ask yourself five critical questions:

1. Does my enterprise fill a gap in the market with a unique good or service?
2. Is the market for my product expanding fast enough to allow me, as a new entrant, to make good money from it?
3. Does my product have a unique selling point that makes it more attractive than other offerings on the market? (for example: being easier to reach than other providers, having a unique feature, offering superior branding, style or customer service)
4. Can I sell my product for less than the competition and remain profitable?
5. Does my enterprise deliver unique social and environmental benefits that might open up other sources of funding? (If the competition does not have the same social or environmental impact, you could access grant funding and preferential debt and equity to gain a competitive advantage.)

Unless you can answer 'yes' to at least one of these five crucial questions, it is unlikely that your social enterprise will be able to sustain itself and expand in its current form. If you have answered 'yes' to at least one of these questions, then it is worth articulating, in your business plan or other promotional document, exactly what your competitive advantage is and, based on this, how you plan on growing your business. This information will be of crucial value to funders, who will scrutinise it to see whether your enterprise has the potential to grow and deliver strong financial and social returns.

You have exhausted local options

Most enterprises, social or otherwise, get started using resources that are locally available. Entrepreneurs will run enterprises out of their own homes, and use facilities and equipment that they find in their community. Financing for the initial test phase of a business often comes from personal savings, the contributions of friends or family, cross-subsidisation from another business, or loans secured against personal property. If your organization exists as a cooperative, membership fees may be an effective way to raise funds.

> *"Try to make it work first, before applying for funding. Once there is something working, and the people commitment is shown, funders will be more receptive."*
>
> PlaNet Finance South Africa, Microfinance provider creation organization

Even if you are using personal or local sources of finance, you should, however, set up a dedicated business or organizational bank account.

Local businesses are often important sources of support. Even if they are unable to donate cash to your enterprise, they may be able to offer donated or subsidised office space, printing, photocopying, phone or internet facilities, use of a vehicle, or staff support with administration. Approaching these businesses with a professional pitch and a compelling statement of the social need that your enterprise is addressing may help you get results. It is advisable to start by approaching those businesses at which you have a contact.

Some entrepreneurs choose to access initial finance by bringing in a partner who has cash to invest in the venture. Apart from the money that the partner might bring in, there are other advantages: new skills and expertise into the decision-making process, another person to bounce ideas off and help with important decisions and an obvious successor should something happen to you. These must be weighed against the disadvantages of surrendering some degree of control in the business, and the risk of the breakdown of the enterprise should you fall out with your partner. For social enterprises, it is particularly important that your partner shares in the social or environmental mission of the enterprise.

Personal and local financing methods are often onerous, but your confidence in your idea and enterprise must be high enough to make them worthwhile, or external finance providers will likely show little enthusiasm towards your proposal.

Should you succeed in securing a loan for your enterprise, you will probably be asked to make a contribution of your own towards the financing of the business, so you need to be prepared to set money aside for this purpose. It is essential that your own credit history be intact when looking for finance. In the early stages of an enterprise the boundary between entrepreneur and enterprise is blurry and finance providers will look unfavourably upon entrepreneurs with poor credit histories.

You are run as leanly as possible

Succeeding in business and making yourself attractive to financers are in many ways the same thing. To maximise the money that is available to invest back into the business it is essential that costs be kept to a minimum. In the first few years of business, be prepared to run on a skeletal staff and with minimal facilities in order to establish the track record of generating revenues, breaking even, and demonstrable social impact that many funders will look for.

> *"Keep infrastructure as low as possible."*
>
> Learn to Earn, a skills training and job creation organization

Minimising your cost base will both make you more attractive to finance providers, and reduce the amount of finance that you will require in order to expand your operations. Ways to do this include running the enterprise from home or from donated office space, making your collection of debts from customers more stringent by reducing payment periods, improving collection of overdue accounts and bad debts, negotiating improved payment periods with suppliers, and selling unproductive assets such as unused computers or vehicles.

Make sure the numbers add up

Many businesses do not initially turn a large profit. However, when applying for finance it is essential that you can provide solid evidence that the enterprise is on track towards profitability. Ultimately your business model must demonstrate that when a realistic level of scale has been achieved, your business can turn a profit based on the demand that is seen to exist for your product. This is called ‘break-even analysis’, and is often a financial requirement for funding. Proving this long term viability is often difficult, especially if the business is not currently profitable, and it requires an in-depth understanding of the market and of your own business processes. Remember that for every additional debt burden that your business takes on, the more profitable it will have to be in order to cover both operating expenses and the interest payments for the loan.

One way to help ‘make the numbers add up’ is by adopting demand-based pricing. Most businesses price their product based on its cost plus a small mark-up. In reality, you should try to price your goods at the level that customers are willing to pay for them. If your product is unique this may allow you to make large profits. If the amount customers are willing to pay is lower than the cost of production of the product your business is not competitive and you must either cut costs, target new markets or alter the product to improve its appeal. Some social enterprises deliberately set their prices below costs to serve underprivileged communities (this is true of many microfinance institutions), but these must have reliable grant sources to cover the difference.

It may seem as though these strict business criteria are too harsh for investors that are looking primarily for social or environmental impact. However, social and impact investors look at financial criteria for two crucial reasons. The first is sustainability. Funders want to be sure that once the money they provide has run out, the enterprise will be able to continue to benefit the community and not fizzle out through lack of resources. The second is scalability. Operations with a strong model and the ability to generate surpluses can generally be replicated elsewhere without large long term funding inputs, and this offers funders the opportunity to greatly expand the social impact that their investment will create.

“Businesses should ‘bootstrap’ their way to the starting point for investment.”

EDGE Growth, an enterprise development consultancy



CASE STUDY 3

SHONAQUIP

Bootstrapping your way to success

Background

Shonaquip was established by Shona McDonald in 1992, after she struggled to find an appropriate wheelchair for her daughter Shelly, who was born with cerebral palsy. Through small fundraising events, the help of a local biomedical engineer and her own skills as a sculptor, Shona designed her first mobility device. Using 'the proceeds from one chair to pay for the building of the next one', Shonaquip has grown into the largest supplier of postural support mobility devices in Africa, employing 65 people. Shona keeps the business lean to keep margins competitive, designing the products herself and running the business from her own home. Shonaquip's mission and promise is to enrich the lives of people living with disabilities through innovative mobility and seating solutions, sustainable support services, holistic advice, training, research and policy change.

Financing history

Shonaquip has never accessed grant funding, and has grown exclusively through the sale of their unique mobility devices. Shona has accessed debt facilities through her own personal assets to help with inventory management, taking out loans on her own property and using an overdraft facility with her bank. She used a loan from a patient investor on her advisory board to resolve a short-term cash-flow issue.

Shonaquip has benefitted from in-kind donations of expertise and mentoring services, including a financial advisor, biomedical engineer who assisted with designs and an engineer provided by the Small Enterprise Development Agency (SEDA) who helped develop a stock management plan. Shonaquip earns 100% of its revenue through the sale of goods and services: mobility devices and clinical services such as the community based outreach seating services it provides to NPO's and the Department of Health. The income streams are roughly divided between government tenders on the one hand, and non-profits and medical aid companies on the other.

Corporate structure

Shonaquip operates as a for-profit Pty Limited. It recently established a non-profit foundation, which is a Section 21 company with both Public Benefit Organization and Section 18a status. The purpose of the foundation is to increase awareness of and access to user-appropriate mobility and seating solutions, facilitating access to holistic user-focused support services and drive relevant policy change and research to support an inclusive and empowered society for people living with disabilities. The foundation has a 25% equity holding in Shonaquip (Pty), allowing funds to be channeled in from the for-profit, although it is also seeking grant funding to carry out its research.

KEY TAKEAWAYS

- Many of the best entrepreneurial ideas stem from personal circumstances.
- It is possible to thrive without significant external funding, even as a social enterprise, so long as you keep your cost base as low as possible.
- Successful social entrepreneurs are often stake their own assets and resources on the success of the enterprise.

What are the origins of your enterprise?

As an established organization with enough common sense to pick up this guide, it is likely that you already have some formal business planning, financial reporting or impact assessment in place. However, depending on the origins of your enterprise, you may need to strengthen your business credentials or your monitoring of positive social results in order to successfully obtain financing.

In South Africa we have identified three types of social enterprise. The first have considered themselves social enterprises from their inception. They understand the need to run as a serious business with sturdy financial planning, as well as the importance of having a strong focus on social impact, and ensuring that it is thoroughly reported and maximised through the way the organization is structured.

The other two types are much more common. The second variety is an organization that began as a traditional non-profit, providing a free service to disadvantaged beneficiaries, and receiving grant funding from private donors and the government to cover their expenses. They then develop a revenue generating arm to help supplement these unstable income streams, and as they grow this market-orientated activity they come to see themselves more and more as a social enterprise.

These organizations often excel at providing benefits to the people they serve and fulfilling a social mission, and require only superficial changes in their operating model to enable them to monitor and report their social impact for potential investors. They struggle, however, with the more technical aspects of running a business: market research, financial planning, business plan preparation and cash-flow management. The first part of this section, which deals with the basic business materials that many funders will require before considering awarding finance, should provide these enterprises with the basic components of a solid business model that is considered fundable.

The final type is a conventional for-profit business that wants to shift its focus towards the alleviation of a social or environmental problem. These organizations face the opposite problem to non-profit converts: they may have strong business acumen and the appropriate management and financial planning in place, but lack a clear definition of their mission and vision, and have no way of measuring and reporting impact. The second part of this section should help these organizations familiarise themselves with the basic components of a social enterprise orientation, as well as introduce them to the concept of social impact reporting.

What are your financial requirements?

Potential funders will ask for large amounts of detailed information about your enterprise before making a decision. This is not only to help them determine the viability of the business, but to demonstrate that you, as the entrepreneur, are making strategic decisions based on recent, accurate data and reasonable, supported assumptions. The most relevant information, that which demonstrates the feasibility and sustainability of the business, should be condensed into a **business plan** (see below), but all relevant information should be prepared and available for any funder who requests it.

To come through the most rigorous finance application process in one piece, you will need:

- A **strategic plan** for the business, setting out how it would respond to various risks and challenges.
- Key **financial statements**, including:
  - **Income statement**, incorporating the projected revenue and expenditures of the enterprise over a given time period.
  - **Cash-flow statement**, showing inflows and outflows of cash into the business, giving a strong indication of its liquidity and viability.
  - **Break-even analysis**, showing what conditions would be needed for the business to cover its costs and start making a profit (break-even point describes the position

where no profit or loss is being made). This is especially important for early-stage social enterprises looking to demonstrate their long-term sustainability.

- **Balance sheet**, which describes the current financial state of the business in a 'snapshot', showing the assets owned by the business, the amounts the business owes to debtors (liabilities), and the amount left over (equity).

- A strong **governance structure**, with a board consisting of at least the legally mandated number of members from various relevant fields of expertise. The board must meet regularly with full attendance, and take detailed minutes of proceedings.
- **Market research** which shows an understanding of your competition and customer base, and suggests your unique potential to grow in the industry.
- Descriptions of your **management team**, explaining their qualifications to grow the business after new financing has been obtained.
- Physical **documentation** for all aspects of your business, including audited financial statements, registration documents, credit checks, descriptions of assets and liabilities for all partners, directors and members, and other key financial and business documents (see Section 6 for more details).

> *"Your accountant must be a world class professional with a strong work ethic."*
>
> Maths Centre for Professional Teachers

Obtaining the help of a competent accountant, and, in some cases, legal advice, is critical in making sure that all of this documentation is in order and that your business is ready to apply for funds. Some non-profits and social enterprises can obtain these professional services on a discounted or pro-bono basis through their network, the local community or a beneficiary.

However, having accurate, up to date accounts and solid financial planning is an area that no social enterprise can afford to gloss over.

For NGOs looking to establish a revenue-generating stream or an affiliated for-profit, there may be a need for additional financial management capability in your staff. This could be met by training existing staff, recruiting an advisor or board member with the necessary skills or experience, or finding a qualified individual through your network who is prepared to offer their services to the enterprise, preferably for a reduced rate or for free.

It is worth adding that collecting this information is only half the battle. In order to fashion a business that can really thrive and attract funding, you will have to act on your market research, cost and revenue projections and strategic planning to make the business as financially and socially profitable as possible. This will in turn make your enterprise even more appealing to funders.

What are your social requirements?

A social enterprise will have unique elements in its business plan that many grant providers and social investors will look for. These elements should allow you to position your business as responding to a real social or environmental problem with a clearly articulated, market-based solution. It should also offer ways to measure and evaluate the success your business is having in tackling the problem.

Not all providers of finance will insist on the inclusion of these items, but they are critical for those that specifically target social enterprises.

Problem statement and your solution

Articulate the problem that your social enterprise seeks to address, making it geographically specific if applicable. Provide quantitative and qualitative evidence that the problem is not currently being adequately addressed, and that other organizations (the competition) are failing to deal with it completely. Briefly explain your solution. The body of the business plan will explain the solution in detail, but you will want to begin by describing how your enterprise can effectively tackle the social problem that you have identified.

Vision and mission

While many traditional for-profit companies have a mission and vision, these take on added importance for social enterprises. They are the fundamental commitment that an enterprise makes to dedicate itself to the amelioration of a social problem. Living by your mission and vision will be crucial in differentiating your enterprise from other for-profit ventures by qualifying as a social enterprise in the eyes of potential funders.

A **Vision** is a broad, long term aspiration of the way that you would like to see the society, in which your enterprise operates, change. It is a description of the world that you would like to create.

Example:

> *"Ashoka envisions an Everyone Changemaker world that responds quickly and effectively to social challenges, and where each individual has the freedom, confidence and societal support to address any social problem and drive change."*
>
> Ashoka, an organization dedicated to the support of social entrepreneurs.

A **Mission** is a succinct statement of how your enterprise can contribute towards making the vision a reality. Your mission should describe the fundamental *raison d'être* of your organization.

Example:

> *"Our mission is to harness Africa's entrepreneurial spirit and innovations in technology to enable rural Africans to improve the quality of life and economic wellbeing in their communities."*
>
> Connect Africa, a social enterprise that provides telephone, internet and business services to remote areas of Southern Africa.

Theory of Change

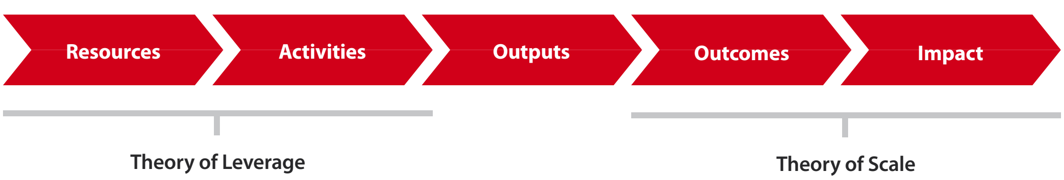

Figure 3.1: The Theory of Change Progression

A theory of change explains how your organization will go about achieving its mission. A successful social enterprise mobilises monetary, physical and human **resources** to undertake certain **activities**. Those activities have certain direct and tangible results (or **outputs**), which connote a level of performance or achievement, or a desirable social **outcome**.

The outcomes of your enterprise should make a tangible social **impact**.

Here is a simplistic example. I have a stand that sells vegetables in the townships for affordable prices:

- My resources are the vegetables, the stand from which they are sold, the individuals that sell them and manage the operation, and the idea itself.
- The activities are sourcing the vegetables, marketing them, selling them to customers, and tracking changes in diet in the customers.
- The outputs are increased vegetable availability in the township, and increased vegetable consumption.

- The outcome is healthier and better nourished individuals in townships.
- The impact is a meaningful solution to the nutritional deserts that are found in many low income areas, improving levels of health and productivity in those areas.

A strong theory of change, supported by empirical evidence and reasonable assumptions, is crucial in convincing socially-minded investors that your enterprise is actually capable of addressing the problem that it seeks to alleviate in its mission.

See www.theoryofchange.org for help with crafting a theory of change.

Measurement and evaluation

Wanting to make a social impact is good. Having a plausible theory of change to make it happen is better. Being able to measure, evaluate and prove the social impact is best, and often necessary in order to convince social investors to put funds into your project.

The first stage in measurement is identifying the factors that are easy to measure that might indicate success at tackling your social problem. Metrics may seem like a complicated field, but are simple to find. Ask yourself: "What am I trying to achieve with my enterprise?" (your mission). Then ask yourself: "What would prove that I am successfully achieving these goals? What would success look like?" You can then determine direct or indirect ways of measuring the changes towards which you have contributed.

For the vegetable stand, you could easily assess the number of vegetables sold and, presumably, consumed. You might also want to survey customers to see, for example, how many children or unemployed individuals are benefitting. Indirect measures (known as heuristics) can give you hints about your social impact. These could include the number of days of sick leave taken from work or school by the people buying the vegetables, compared with those that aren't, or assessments of body weight and muscle mass between the two groups.

Funders do not expect you to establish perfect causality between your enterprise and positive social change, nor do they expect you to track and cover every beneficiary you have ever had. But they do expect you to be able to provide convincing, well supported evidence that your programme actually works, and that your theory of change is a true reflection of real world circumstances. Many funders, especially impact investors, will have their own tools for assessing social and environmental impact. Others will look to your internally generated assessments, so it is important that you have them, however basic they may be.

More sophisticated social enterprises may want to use established social reporting mechanisms to assess and communicate social impact. The best known of these are:

- The Social Return on Investment method (SROI), which quantifies social impact to give a Rand value of impact to evaluate alongside financial bottom lines.
- The B-Rating by B-Corp, which assigns a numerical value corresponding to the social impact of your organization.
- Sector specific tools such as MIX markets for microfinance and Trucost for environmental impact.

TRASI contains a searchable database of these tools, which may help your social enterprise identify and adapt an appropriate measure: http://trasi.foundationcenter.org

Sustainability

Sustainability is a buzz-word in social enterprise circles, and for good reason. It can be used in one of two ways. Firstly, is your business sustainable once the financial injection from grant, debt or equity that you are seeking has run out? Do you have a feasible plan to generate revenue from the sale of goods and services, or other grants in the pipeline? Secondly, is the positive impact on the community sustainable? If your vegetable stand in the townships folds after six months, the health and nutritional gains for the community will gradually be undone. If the stand is complemented by nutritional education sessions, cooking lessons and the selling of seeds and equipment to help people grow their own vegetables, the sustainability of the impacts is likely to be higher. Venture philanthropy, impact nvestment and many progressive CSI donors and grant-making foundations will focus strongly on sustainability. Discussions of sustainability should run through your entire business plan, and also be treated in a stand-alone section.

CASE STUDY 4

SMALL ENTERPRISE FOUNDATION (SEF)

Accessing Socially Responsible Investment funding

The Small Enterprise Foundation (SEF) is a not-for-profit, pro-poor microfinance institution working towards the eradication of poverty by creating a supportive environment where credit and savings services foster sustainable income generation, job creation and social empowerment. Since its founding in 1992, it has distributed more than 700 000 loans to impoverished clients, and currently has more than 60 000 active clients.

Financing history

SEF was looking to expand operations in the Rustenburg area, with the aim of serving more than 12 000 clients by 2013. It was approached by the Cadiz Asset Management Sustainable Development Fund in 2009, with a view to making an investment in the corporation to allow it to carry out its proposed expansion.

Details of the SRI investment

The Cadiz Asset Management–GreaterCapital fund made a R20 million investment into SEF over a 5 year period. Since SEF is a Section 21 company, equity investments were not possible, and so a loan was negotiated. The loan currently yields market-rate interest rates of around 12% in 2010.

As a condition for SEF's loan, numerous covenants were agreed upon that covered:

- Criteria for the long term portfolio performance of its operations.
- Financial covenants relating, but not limited to the capital, liquidity and profitability requirements.
- Social covenants that broadly define the social purpose of the investment and bind the SEF to uphold its social mission towards developmental change.
- Specifications for security requirements, repayment terms and events of default.

SEF and impact reporting

SEF was given an Σα rating by GiveWell (corresponding to 'very highly recommended'), which uses MIX Market methodologies to determine the social impact of microfinance institutions. Thus far, SEF's social return on investment was has been calculated as 295% (using SROI methodology). This concrete demonstration of social efficacy, along with its strong financial performance, makes it an attractive proposition to socially minded investors.

KEY TAKEAWAYS

- Large debt and equity investments are available for social enterprises in South Africa, but these must combine strong financial results with rigorous impact reporting.

The social enterprise business plan

In order to successfully apply for almost any non-grant funding, you will need a strong business plan. The business plan assumes the same role in debt and equity finance as the proposal plays when applying for grant financing. The business plan should not only explain the details of the running of your business, but must also demonstrate a strong understanding of your target market and competition, and include detailed financial projections grounded in the experience of similar businesses or on other real world assumptions. According to a senior manager at Khula, the most critical aspect of a business plan is that the numbers add up: the projections of cost and revenue must show your business turning a profit, at least in the long term, and must reflect conservative estimates of the demand for your product.

There are many general business plan guides available online (some are listed in section 7), and through intermediaries. Guidance on how to write a business plan appropriate for your business is provided by many of the technical assistance providers listed in section 7.

Writing a business plan for social enterprise requires a skilful blending of the language that non-profits and others in the development field use to describe their work, and the finance-oriented, business lexicon of the for-profit sector. Depending on the origins of your organization, you will want to make sure that you are familiar with the 'other' side's favourite vocabulary; if your business plan uses the word 'capacitate' fifty times but the word 'leverage' zero times, you may want to consult a business-minded contact for some re-wording! When distributing business plans to potential financers, you might want to tailor the language and content to speak to their specific background, just as you would adjust a cover letter or CV based on the employment for which you are applying.

> *"Stick to the business plan, refer to it constantly, preferably at weekly meetings. It is not just a document to convince finance providers and stakeholders, but a guide to how your business is actually run."*
>
> Khula Enterprise Finance

4. WHAT SORT OF FINANCE SHOULD YOU BE LOOKING FOR?

If you come from a development background and think that equity is another way of describing social equality, look no further! This section will explain the different forms of finance from the ground up.

This section will:

- Outline how grants, debt and equity work, and the general pros and cons of each
- Describe the various financial instruments associated with grants, debt and equity, and explain how they work
- Help you identify which type of finance, and which specific instrument is most appropriate for your financing need and organizational maturity

Types of finance

Grants

Grants are best described as donations to organizations, usually from charitable foundations or the government. Traditionally, non-profits have subsisted primarily or entirely on grants. Grants have one obvious advantage: they do not have to be repaid. However, grants have several limitations which mean that relying entirely on them is not always a wise move for any social enterprise, and indeed the social enterprise movement is largely a recognition that organizations that have some degree of self sufficiency are more stable and therefore more likely to continue to serve their beneficiaries in the long term.

> If you are a non-profit with a small revenue-generating arm, a trust or a grassroots organization empowering previously disadvantaged groups, then grants will probably constitute a significant portion of your revenue.

Advantages

- Grants do not have to be repaid (with the exception of recoverable grants).
- Grants can cover costs while building up a revenue generating activity.
- Grants can sometimes be used to purchase assets which will generate revenue and/or provide security to the organization.
- Grants can fund non income-generating activities (such as this guide!)
- Grants can fund risky but socially beneficial activities that have a high social impact, such as research and development and best practice studies.

Disadvantages

- Grants are often short-term, making it hard to make long-term financial plans based on them.
- Grants are often paid in arrears, causing cash flow difficulties.
- Applicants for grants compete directly with each other and must expend considerable human resources identifying and applying for the various available grants. Applications and ongoing reporting require specific skills and must usually be tailored to each donor.
- Grants are usually tied to specific projects; it is harder to obtain grants for core funding (operating costs).
- Grant donors have specific niches and priorities which may follow trends and abandon long-standing programmes.

- Grants can skew the mission of the organization away from its original purpose and towards funder's priorities (known as mission drift).
- Many grants do not accept applications from for-profit entities, and some do not even accept revenue-generating non-profits. Others limit the profits that an enterprise can make.
- Grants tend to be inflexible and it is often not possible to change their terms.
- Grants tend to follow economic cycles in terms of both availability and generosity.

Debt

Debt is the term used to describe money that is loaned to you by a financial institution on condition of repayment, usually with interest (a payment of a certain percentage of the amount you take out that must be paid back in addition to the original amount, or principal). Debt is the primary finance vehicle in the private sector, especially for small and medium sized businesses.

> If you are a for-profit business with a social mission, or an established non-profit seeking to expand in scope or generate more revenue raising activities, then debt will likely be an important source of finance for strategic needs.

Advantages:

- Unlike grants, loans are rarely tied to outputs or outcomes, giving greater flexibility to the debtor (although 'patient capital' loans may require certain social impacts in order to continue or extend finance).
- Loans are usually quicker to obtain than grants.
- Loans are assessed on their own merits, rather than competing with other applications for a limited pool of funds (as with grants).
- Taking a loan can improve financial management and, when responsibly serviced, build credit history.
- Interest paid on debt is tax-deductible in South Africa, which reduces the overall burden of the debt.
- By adding money to the business without introducing a new investor, debt can increase the return on an equity investment, since the 'extra' profits that the debt can help generate will flow to the same number of shareholders. Debt is therefore described as able to 'leverage profits'.

Disadvantages:

- Lenders often require security or collateral (items that the lender can sell to get their money back if your business goes under) when issuing debt, such as property or equipment, which may be seized if you cannot meet the repayment conditions.
- If your enterprise does not have assets to be used as security, getting a loan can be difficult. Credit indemnity schemes, such as Khula's, can provide security on your behalf, but come with their own stipulations. Additionally, development finance guarantees are available from institutions such as Tembani International Guarantee Fund (TIGF), which also provides security on debt obligations.
- Loans must be repaid with interest, creating a long term financial drain on your organization. Generally a loan should be used to finance an activity that will generate revenue in excess of the cost of the repayment of the loan with interest.
- Lenders look for historical support of the stability of the business when making financing decisions, so loans are rarely issued to start-ups.
- Taking on debt may reduce your ability to secure financing in the future if the repayment burden is seen to increase the riskiness of your business. Finance providers will look at your ratio of debt to equity and other leverage ratios as a means of assessing the stability of your business, and, generally speaking, the lower the percentage of debt, the better.
- In the wake of the financial crisis, debt is harder to secure. Commercial lenders tend to lend only to very low risk ventures, which often precludes social enterprises. In South Africa, the high failure rate of enterprises leads to high interest rates being charged on loans to SMMEs.

Equity

The word equity is used to describe any money that is 'owned' by the business and does not have to be repaid. This includes cash reserves and trust funds. However, from this point onwards, we will use the term 'equity' to refer to money that has been invested in a business in return for an ownership stake or shareholding.

> If your organization has high growth potential (while achieving a social mission) and is looking to secure significant injections of capital in addition to new expertise and leadership, then you should consider issuing equity.

Equity involves selling a portion of the ownership of the enterprise to outside investors, which, depending on the valuation of the company, can generate substantial cash. However, the complications that new owners introduce must be carefully considered. Investors in conventional equity deals will expect to be compensated both through dividends paid out of the profit made each year, and by selling the shares at a higher value than they bought them (capital gains).

It is worth noting that issuing equity will close off certain funding options to your organization, and will require it to be incorporated as a for-profit company (and thus as ineligible for any tax exemptions).

Advantages:

- Equity is best for raising very large sums of money.
- By bringing extra capital into the organization, equity can increase the financial cushion that an organization has should there be a short term cash shortfall.
- No security or collateral is required.
- There is no contractual agreement to repay investors the amount they put in.
- Hands-on investors can bring valuable expertise and experience to an enterprise.
- Equity investments are often available for ventures that debt providers such as commercial banks would find too risky. A high rate of return is expected from such investments.
- In contrast to debt obligations, equity returns may be low or nil in the early years of an investment (which would be suitable for start-ups). With debt, interest repayments are usually due monthly or quarterly and are thus less suitable for early stage organizations.
- An increase in equity can increase the ability of the organization to borrow in the future by reducing its risk profile.

Disadvantages:

- Issuing equity requires giving up a stake in the business, which means that even if the business is growing, the size of your stake in it may not increase at the same pace.
- Issuing equity often involves incorporating the wishes of new stakeholders into your strategic planning. For social enterprises, it is particularly essential to select shareholders who agree with your social mission and theory of change so as to avoid mission drift in pursuit of financial returns.
- Only for-profits can issue equity in South Africa.
- Many equity investors will only buy stock in companies with high growth potential and strong profitability, which many social enterprises may struggle to demonstrate.
- Equity deals are often complex, deterring many enterprises. Any enterprise considering an equity investment must be able to accurately determine its value (assets, intellectual property etc.), which can be complicated.
- Equity investors may be discouraged if there is not a clear exit option for when they wish to sell their stake. An exit option is a way for investors and shareholders to sell their stake in the business when they wish to end their involvement in it. They may sell it to other investors, the management or to a regulated exchange if the equity is listed. In South Africa, exit options are rather limited in the nascent impact capital market.

Patient Capital

All financing can be categorised in one of the above three categories. However, there are specific subsets of each type of financing which target social enterprises, and may be more accessible than traditional sources that are geared towards pure for-profits or pure non-profits.

Patient capital is the term used to describe finance that aims for long term results, whether financial, social or environmental. It can consist of combinations of grants, debt and equity, and the repayment requirements on it are subordinate to the desire to see the enterprise succeed and generate strong social and/or environmental returns. When grants are used, they often adopt a 'venture philanthropy' approach (explained below) which emphasises social reporting and accountability.

- For debt, patient capital often consists of 'soft loans' or quasi-equity instruments (see below) which may have very low interest rates, long repayment periods, or the option to convert to grants or equity if the business struggles.
- For equity, patient capital allows the investor control through an equity stake whilst demanding comparatively low rates of return from the enterprise.
- Patient capital also includes types of convertible grants, which become equity or soft loans if the business succeeds.

Advantages:

- Patient capital takes a long term view of your business, and is often willing to wait several years before expecting any return on investment.
- Patient capital often incorporates the flexibility to pay back financiers only as much as your enterprise can afford (similar to equity).
- Patient capital typically has lower collateral requirements than commercial debt.
- Many patient capital providers also provide mentorship programmes or other technical assistance, and bring leadership and expertise to the enterprise that may help it succeed.

Disadvantages:

- Patient capital, and especially impact investment funding, is relatively rare in South Africa, and enterprises seeking patient capital must usually apply to Development Finance Institutions, which have specific regional and sector foci, or Enterprise Development funds, which are largely available only to black-owned businesses.
- Patient capital often has high social reporting requirements, and recipients of patient capital must usually demonstrate strong and sustainable social impact as well as organizational sustainability.

CASE STUDY 5

THE PHAKAMANI FOUNDATION

Demonstrating success before taking on debt

Background

The Phakamani Foundation is a microfinance organization based in Mpumalanga. It was established in 2007 by Mark and Shirley Tucker. Since 2008 it has made over 4000 loans with a value of over R5 million to some of the poorest members of local communities.

Financing history

The initial funding for Phakamani came from local sources and the communities of the founders. Donations from the Tuckers as well as friends and business associates in their homeland of Canada, South Africa, USA and Australia, got the organization off the ground. A loan from a friend in SA for R750 000 at below market interest rates allowed Phakamani to start lending. After beginning operations, the Tuckers waited another 18 months before seeking more funding for expansion. According to Mark Tucker, this minimized the risks that failure would entail (since the foundation would not owe large amounts of money) and saved the likely major funders for later, when the enterprise was able to appeal more convincingly for larger sums of cash. Their first major loan came in 2009 from Tembeka, who loaned the foundation R500 000 at slightly above market interest rates, to be used exclusively for on-lending. More recently the foundation has received larger investments by a corporate foundation, a DFI and a Socially Responsible Investment fund:

- The Deutsche Bank Trust provided a R600 000 loan with a market interest rate and a R150 00 grant.
- The South African Microfinance Apex Fund (SAMAF) provided a R3.5 million loan with a below-market interest rate, along with a R1.75 million grant.
- Masisizane (Old Mutual's SRI fund) provided a R6 million no-interest loan and a R1 million grant.

Appealing for grants along with loans is a necessity for Phakamani, since although they recoup 34% of their costs in loan repayments, they need a significant additional input of capital to cover operating losses in order to keep interest rates affordable to their beneficiaries.

KEY TAKEAWAYS

- Establishing a proven track record of success before seeking large quantities of funding both reduces the damage that failure would entail (less money is owed) and preserves funding sources for a time when you are more likely to obtain money from them. Note how Phakamani obtained larger loans, at more favorable interest rates, later in its existence.
- Social enterprises can access preferential and soft debt in South Africa, but must inspire confidence in lenders.

Financial instruments

Grant Instruments

Grants display less financial sophistication than debt and equity. This is because they do not have to be repaid. There are important differences, however, in how grants are made, what they can be used for, and the amount of money that is at stake.

Donations

This is the most basic form of grant, usually awarded by individuals or companies. Donations do not require a formal application, and are often un-earmarked so can be spent on any aspect of the programme for which they are given. Donations are sometimes raised through membership fees. An important type of donation for the young social enterprise is the in-kind donation, where companies provide for free the goods or services that they normally sell to the market. Through sheer persistence and determination, many social enterprises are able to procure internet access, vehicles, and even accounting and legal services for free. The online community www.myggsa.co.za allows South African non-profits to request and receive donations in cash and in kind.

Grants

These can come from various sources, including private individuals, companies, foundations, DFIs, and other branches of government. They often require an application in order to be awarded, and may require ongoing reporting of social and/or environmental impact. Grants may be general and un-earmarked, assigned to specific programmes or research projects, or to skills training and capacity building.

Award grants

These are grants awarded through a competitive tender process. They often have extensive applications intended to identify the organizations that align most closely with the priority areas of the funds.

Aid grant

These are administered by domestic or foreign DFIs and international institutions such as the World Bank. They are often awarded to national and local government and are large amounts (above R10 million).

Convertible grants

These are a type of patient capital, and have recently been employed by impact investors and venture philanthropists. A grant is given to an early-stage organization, with the understanding that if the enterprise becomes large and profitable, the grant will be converted into a loan or into an equity holding. These can also work in reverse, with loans becoming grants if the company runs into difficulty and fails to grow as expected. These are a type of mezzanine finance (a combination of debt and equity – see below).

Venture philanthropy

Also known as **philanthro-capitalism**, venture philanthropy offers grants but uses a business-based approach, often including a rigorous evaluation process and sustainability analysis with a strong emphasis on impact reporting. Venture philanthropy will often provide long term grants and technical assistance to promising early stage non-profits and social enterprises, but will demand evidence of the impact that the investment is having.

Debt Instruments

Debt instruments are the most developed and complex form of financing. Generally, the more risky the debtor enterprise is perceived to be, the higher the repayment and interest obligations are. Unless otherwise stated, all of these debt instruments are available from major retail banks or their subsidiaries, with many being available at favourable interest rates at Development Finance Institutions or through Enterprise Development schemes.

Short-term debt: for cash-flow management

Credit card

The most familiar type of credit is also one of the most expensive. Credit cards allow you to spend more than you repay to the credit card company up to your credit limit.

Any balance on your credit card that is not paid off within the repayment period is charged interest, which is usually higher than what is charged on other forms of debt. Credit card statements are issued for the previous month, and must typically be paid within 25 days of receipt, giving you free credit (float) for between 25 and 55 days. Credit cards also offer security with purchases, since the card company usually covers loss through fraud or bankruptcy. Many businesses therefore use credit cards for online purchases. Many banks have dedicated small business credit cards which may offer preferential rates to heavy users. Credit cards are convenient and can help manage short term cash flow bottlenecks, but are not a suitable source of finance in the long term or for large debts.

Line of credit

A line of credit operates like a credit card. Your business can borrow money from the bank up to a certain limit, sometimes restricted to the purchase of a specific class of asset. Interest rates are typically lower than credit card interest rates, but the availability and limit level will depend on the strength of the relationship you have with the bank, as well as the strength of your business. Like a credit card, a line of credit is a revolving credit (and is sometimes called 'revolving credit'): it has no repayment schedule but charges interest whenever there is a balance on the account. A 'working capital loan' is one variation of a line of credit. Banks will often require a minimum payment of a certain percentage of your balance in order to continue using the line of credit. This is also common practice with credit cards.

Overdrafts

An overdraft is similar to a line of credit, but is linked to a business's current account. An overdraft allows a business to withdraw more money from the bank than it has in its current account, paying interest and fees on the deficit until it is paid off. Overdraft facilities are often secured with assets, and are another useful way of resolving cash-flow problems when waiting for grant funding or other one-off payments. However, overdrafts do tend to have high interest rates. Some social enterprises have negotiated preferential overdraft facilities with their banks at low interest rates.

Bridging loans

Bridging loans (also known as bridging finance) are used when there is a lag time between a business undertaking an activity that costs them money (producing goods, rendering services, investing in assets) and when the income is received in relation to that activity. This is very common with grants, which are often paid only once the activity for which they were awarded has been undertaken, and also occurs with some tenders that are paid in arrears. In this case there is a short term cash flow shortage that has not resulted from any weaknesses in the business model. Bridging finance will allow your enterprise to continue to pay its expenses until the payment or grant is received. Bridging loans are usually given for periods of less than one year. Because there is clear risk involved with pegging repayment to a certain grant or payment, lenders will often want to see proof of this future income. Even with this proof, many retail banks will still be reluctant to offer bridging finance to social enterprises, and they are more commonly offered by DFIs such as the Industrial Development Corporation and other providers of patient capital.

Invoice discounting and factoring

These instruments allow businesses to shorten the cash conversion cycle, at a price. It can take 30-90 days to receive payment from invoices, and invoice discounting and factoring allow the bank to pay you immediately for the money you are owed. They charge interest on the forwarded amount (usually prime +1%) and other administration fees for this service. These instruments are another attractive way of resolving short-term cash flow issues, and the cost of this facility will depend on the perceived level of risk associated with those who owe you money. The main difference between factoring and invoice discounting is that under factoring the bank will directly collect payment from your debtors, whereas under invoice discounting you will collect payment yourself. If your organization collects other information when billing clients, or would rather not inform them that you are using these facilities, then invoice discounting may be the better option. Factoring saves your business the administrative hassle of collecting the payments.

Medium term debt

Leasing

Leasing is a way to have use of an asset before you can afford to take full ownership of it.

There are various permutations of leasing. In an **instalment sale** you pay the bank or lender monthly instalments which consist of part of the cost of the asset plus interest.

Once all of the instalments have been paid, ownership of the asset passes over to you.

A typical **lease** involves making monthly payments for a fixed number of months to make use of an asset, after which the bank repossesses it. At the end of a lease, the lessee can buy the asset, refinance it or return it to the bank. Leasing is a better option than instalment sale when the asset is only needed for a limited period, or when its value is very low by the end of the leasing period.

Rental is like leasing except that VAT is assessed differently on rentals in South Africa.

Leasing arrangements are common with vehicles, photocopiers and other large pieces of equipment. A lease can be obtained from a bank or from the producer of the asset (for example, most car companies sell leases on their vehicles). Some leasing agreements will require a deposit to be paid at the start of the lease.

Leases offer a good way to keep cash free that would otherwise be tied up in assets, but in the long term often cost more than purchasing the asset outright. It is also worth noting that since leased items are not classified as business assets, they cannot be used as security for other forms of finance.

Access bonds (also known as Access Deposit Facilities)

These relatively recently pioneered loans allow you to essentially treat a loan taken out for an asset as a savings account. Simply put, access bonds allow you to re-borrow what you have already paid back, at the same interest rate as the initial loan. You can use the equity on the asset to take out additional short term loans at the same interest rate as the original loan, up to the value of the equity. Since this interest rate is often lower than the rate you would pay for other one-off purchases, access bonds are a good way to pay a lower interest rate on such things as cars and other equipment purchases. They also allow you to pay off the loan more quickly by depositing more than your minimum instalment into the account.

For example:

If you have a R1 million mortgage on a property and have paid off R500 000 of it and were paying 10% interest, you could withdraw R100 000 of that equity to buy a vehicle, and avoid the 15% interest rate that is usually charged for cars.

Long term debt

Term loans

This is the most common loan used to fund large asset purchases, and is available from major retail banks. Businesses usually deploy term loans to purchase large assets such as land, buildings or expensive equipment, but can also use them to acquire other businesses or restructure long-term debt that is secured on assets.

Term loans tend to have long repayment periods, typically 2-7 years. By making surplus payments above and beyond the basic requirements of the loan, a business may reduce the duration of the repayment period, and therefore the amount of interest that must be paid on the loan.

Term loans usually require security or collateral, which could either be the asset for which the loan was secured, or another asset held by the business whose value exceeds the loan amount. The lack of security is a major stumbling block for many social entrepreneurs looking for finance. Many have chosen to offer their own property or home as security, but this has clear and significant risks.

An important option for enterprises lacking adequate security to succeed in a loan application is the **credit indemnity scheme** offered by Khula, a DFI. Under this scheme, Khula will guarantee the value of the loan in lieu of security, but the entrepreneur must contribute a certain percentage of the security (2.5% - 10%, based on the loan amount) and convincingly demonstrate an ability to repay the loan.

Most term loans charge interest at a variable rate, which may consist of Prime (published, benchmark rate at which major banks lend) plus an additional percentage based on the perceived riskiness of the loan, the repayment period, and other factors. Since Prime changes with economic conditions, the interest rate on this loan will vary over its duration (**a variable-rate loan**). Some banks also offer **fixed-rate loans**, which specify a given rate of interest for the entire repayment period. Such loans can help financial planning, and are desirable if interest rates are predicted to rise, but risk putting your debt repayments out of line with other financial obligations if interest rates fall.

Term loans are also offered by many of the DFIs supporting small businesses or certain sectors, as well as many of the funds targeting black-owned SMMEs, often with lower interest rates and longer repayment periods.

Business property finance

Just as you would get a mortgage for your own home, you can also finance land and property for your business with debt. Some banks (such as Standard Bank) also offer a 'business mortgage' where you can take out a loan to buy or improve a residential property that will be used as a business, which is common with doctors, lawyers and other professionals, but is also often seen with start-up social enterprises.

Bond issue

This is a way of accessing debt from markets that are more traditionally associated with equity. It is traditionally limited to only large businesses. Your business will effectively sell debt on the open market, for investors to buy and sell. Bonds tend to be long term arrangements, between 5 and 20 years, after which the original sum is paid off. As with other forms of debt, bonds are more attractive when there is collateral.

Equity instruments

Issuing equity can allow a social enterprise to raise more money than through either grants or debt, and also avoids the burdensome interest payments of debt. However, it has important implications for the control of the business and the use of its profits. For social enterprises, issuing equity to investors that do not share the social motivations of the business can put its social purpose at risk.

Share issue

A for-profit business can sell portions of the ownership of the business to other individuals or organizations. This is known as a share issue and can raise large amounts of capital.

As part-owners of the business, shareholders have a right to a say in the operation of the business, which they may or may not exercise. Equity holders are rewarded for their investment with both dividends (the distribution of some or all of the year's profits) and the eventual sale of the shares (ideally at a higher price than they were purchased).

A **private share issue** sees equity sold to a limited number of known investors. A **public share issue** sees the shares listed on a regulated exchange as an **initial public offering** (IPO). This usually involves much larger sums of money and more shareholders. Very few social enterprises worldwide have had public share issues, but the recent, and hugely oversubscribed IPO of SKS Microfinance, is a prominent example. It is also possible to use a share issue for community members or other investors to buy an established enterprise and convert it into a social enterprise.

Private equity

Private equity, or PE funds, purchase large equity shares in firms with the expectation that they will grow strongly and provide value to the fund managers and investors. Some will want a say in the running and management of the company, and may want to place their own executives in key management and governance positions. This can help grow the expertise of an organization, but in the case of social enterprises it risks shifting the mission away from the original purpose and towards financial return. Most private equity funds make only very large investments, which are beyond the reach of most of the likely readers of this guide. They also generally look for very high return on investment in exchange for the risk of being a shareholder and being paid last in the event of insolvency.

Venture capital

Venture capital (VC) describes investors looking for start-ups or early-stage businesses with high growth potential. While these are typically technology-based firms, **social venture capital** funds do exist, and they channel money to promising social businesses. Venture capitalists usually buy a large or controlling stake in the fledgling business. They will prefer businesses that are run leanly and are close to profit or already profitable. In the current climate they will gravitate to those with a marketable asset, in particular, valuable intellectual property.

Mixed instruments

Mezzanine finance

This form of finance is essentially subordinated debt. This is debt with a lower ranking claim on the assets of an organization if it becomes insolvent, i.e. after senior debt has been paid off. As compensation for the increased risk, the interest rate on subordinated debt will usually be quite high. In the event that the organization, the investee, is unable to pay back the debt in time and in full, this form of finance has provision for the subordinated debt to be converted into ownership or equity.

A key advantage of this form of finance is that it is treated as equity on the balance sheet of the investee. This means it can be used to leverage subordinated debt as a means to source additional senior debt.

Quasi-equity

This rather broad term describes finance that has many characteristics of equity, most importantly, that the financial return for the lender/financer is based on the profit of the business rather than an interest rate. However, quasi-equity does not require a formal private or public share issue. It can take many forms, including revenue sharing agreements, subordinated debt, or stock with an equity kicker. Quasi-equity is most commonly offered in the South African context by DFIs, Enterprise Development funds and Impact Investors. They may refer to it by different names. The most important thing to know about quasi-equity is that it offers a viable financing option to enterprises who are not large enough to access conventional equity and who are not sufficiently risk-free to access commercial debt instruments. In the database, many organizations that are listed as offering debt and equity or patient capital offer types of quasi-equity.

Different instruments for different needs

What do you need finance for?

Understanding the reason behind your financing plan will help you target applications to the most appropriate sources and make best use of the funds once they are distributed to you. The most common reasons for seeking finance are listed below, along with the most likely source of finance for each:

Purchasing, renovating or fitting out a building

- Business mortgage for residential property conversion, loan secured with the property, loan based on expected cash generation, patient capital, Bond issue

Purchasing or leasing equipment

- Loan secured by the equipment, loan based on expected cash generation, leasing, instalment sale, renting

Managing ongoing cash needs

- Invoice discounting, factoring, line of credit, bank overdraft, bridging loan, credit card

Funding a growth in operations through increasing staff, increasing production, adding new products or locations, or upgrading systems

- Working capital loan, equity, patient capital, term loan

Converting an established business into a social enterprise

- Venture philanthropy, grants, patient capital.

Starting income-generating activities from a previously traditional non-profit

- Grants, patient capital, venture philanthropy, commercial debt

Research and development

- Grants

Non-income generating activity, expanding product access for disadvantaged groups

- Grants

How much do you need?

The amount of funding you require will in many cases determine the type of funding you apply for.

- Grant amounts can range from very small awards of thousands of to several million Rand.
- Long term debt is usually only issued by retail institutions for moderate to large sums, in most cases, upwards of R50 000. Smaller amounts can be obtained through commercial banks' SMME finance divisions and microfinance institutions. Smaller loans are often also available to SMMEs though DFIs such as Khula and the IDC, and their affiliates such as Business Partners and Cape Capital.
- Equity is usually reserved for larger fundraising efforts, which are measured in millions of Rand. Public listings of equity (on a stock exchange) are usually the largest fundraising activities that can be undertaken. Venture capital can be raised in smaller amounts in exchange for large stakes in the enterprise.
- Patient capital spans the whole range, but is most commonly seen at intermediate amounts (between R100 000 and R10 million).

Difference types of finance for different needs

Start-ups typically struggle to secure debt, and are more likely to obtain capital through a DFI, patient capital, enterprise development funds, or venture capital. These funds tend to be reserved for ideas with high growth potential and reasonably low risk.

In general, debt finance is better suited to more established companies with a proven track record in low-risk markets. Accordingly applications for loans from these companies are more likely to be successful. For organizations in new or high-risk markets that require significant investment, patient capital and private equity may be more fruitful avenues. Figure 4.1 shows the main stages of development through which enterprises typically progress.

During the initial seed and start-up phases, the business is unlikely to be able to support itself financially. It is at this stage that personal and local resources are most critical. These should allow you to begin generating revenues. However, local 'love money' is unlikely to be sufficiently abundant to allow you to truly scale your business and drive it towards sustainability.

Enterprise Development Stage	Seed / Planning	Start-Up: Launch	Start-Up: Survival	Growth and Profitability	Maturity
Age (Guide)	**Year 1**	**Year 2**	**Year 3-4**	**Year 5-8**	**Year 8+**
Core Activities	Idea/ Readiness Analysis	Raising Capital	Revise Strategy/ Business Plan	Stability/Success in Initial Market	Become Sustainable
	Feasibility Study	Preparing to Launch	Build Enterprise and Management Capacity	Expand to New Producs or Markets	Geographic or Product Growth
	Business Planning	Begin Operations	Move to Profitability	Invest in Equipment, Facilities and HR	Spin-offs or New Enterprises are Establishes

Figure 4.1: Stages of Enterprise Development

Source: From a presentation by Wendy Rogers, Van City Community Foundation at the CSR and National Community Investment Forum, University of Guelph, May 17, 2007.

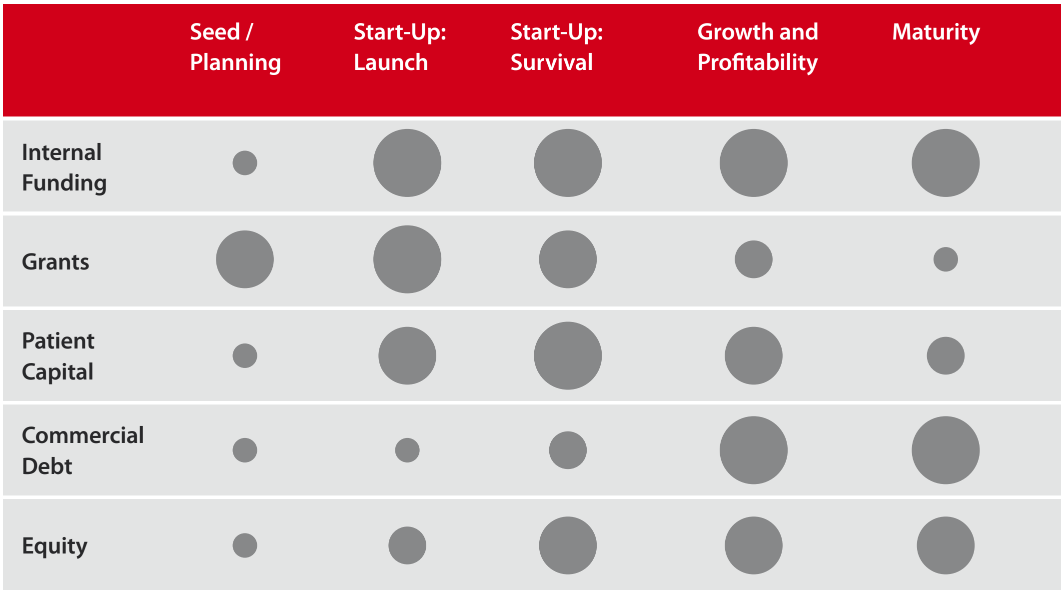

Figure 4.2: Ideal funding mixes for different stages of development
Source: From a presentation by Wendy Rogers, Van City Community Foundation at the CSR and National Community Investment Forum, University of Guelph, May 17, 2007.

For this expansion, many social enterprises look to patient capital. In South Africa, developmental finance, in particular through DFIs such as the Industrial Development Corporation, the National Empowerment Fund and Khula, along with grant finance from corporations and foundations, is the most popular option for obtaining external funding during the survival phase.

The survival phase is the point where your enterprise will 'sink or swim'. If it cannot move towards breaking even at this point, it will likely fail to obtain additional funding or continue to grow unless it is delivering such high social returns that it can continue to attract high levels of grant funding. Enterprises in the survival phase would do well to have cash reserves to allow them to survive for as long as possible without external finance. This allows for better financial planning and improves your bargaining position vis-a-vis potential finance providers.

Enterprises that progress beyond the survival stage are breaking even and can look to expanding production to new markets. Once you have a track record with a clear market and sustained cash flow, debt providers will be confident that your risk of defaulting is sufficiently low and thus more willing to lend you money.

Once your enterprise is truly established, it will be able to access diverse sources of capital, and should look to obtain financing through multiple channels, so as to not be overly reliant on one source. True equity investments, whether private or public, become feasible at this stage. Reliance on patient capital and grants will decline, but may continue to allow you to provide your product to groups who may not be able to pay for it themselves.

Figure 4.2, above, shows the progression from grants to debt and equity that many typical social enterprises will make as they grow and mature. The size of the dot denotes the appropriateness of that type of finance for the given stage of development. While these guides are a useful benchmark against which to determine which source of finance might be appropriate for your organization, it is very generalised. High-growth organizations, non-profits developing a revenue-generating arm, and conventional businesses converting to social enterprises will all have very different trajectories and find different types of finance appropriate.

5. WHO OFFERS FINANCE?

This section will:

- List the main types of finance provider in South Africa
- Describe the financial return expectation of different types of finance provider

Identifying sources of finance

While the resources in this guide are a good starting point for financing options, there may be other suitable options that may finance your local area or specific industry. As an example, many mining companies look to finance projects within the vicinity of the mine. Ask your bank and people in your network about potential financing options, and pursue several simultaneously. An informal conversation with a funder may reveal other potential sources of finance. When applying for debt, having several quotes can help to negotiate better terms of repayment. Remember that lenders compete for business just as much as businesses compete for finance!

What types of finance provider are there in South Africa?

Accompanying this guide is a database of major social finance providers in South Africa. The database can be manipulated by the type of legal organization they target, the sector and the size of the enterprise, and by the type and size of finance offered. Manipulating the database along these parameters should provide you with a list of funders that might be interested in your enterprise. Funders use differing terminology and periodically shift their focus, so it is worth casting a wide net.

The finance providers can be grouped in the following ways. This grouping is according to their source of finance, rather than the organizations they look to fund:

Retail banks are the principal providers of debt in all its forms. Many have products tailored to small and medium enterprises. When seeking finance from a retail bank, it is best to start with those with whom you already have a relationship. Retail banks tend not to offer patient capital or soft loans but many have branches that cater to enterprise development as part of their BBBEE initiatives. These may offer preferential finance to qualifying institutions.

Microfinance Institutions lend out small amounts of money to local entrepreneurs. Many loans will be for very grassroots initiatives that lack the sophistication to be seen as true social enterprises. Some, however, will give larger loans to more established businesses, and these have been included in the database.

Corporate Foundations have diverse targets, but often direct funds towards either socio-economic development or enterprise development as part of their corporate social investment/ BBBEE programmes. Most provide grants to organizations fitting their geographic and sector priorities, but many also provide in-kind donations, soft loans and technical assistance to successful applicants. Some smaller corporations direct their Enterprise Development spend through intermediaries (as do some government DFIs). Enterprise Development spend must usually be channelled towards for-profits, while Socio-Economic Development spending cannot be used on traditional for-profit companies, except occasionally when there is a direct link to the employment of long-term unemployed or disadvantaged individuals.

Development Finance Institutions are government or international institutions that seek to pursue development aims through the provision of finance. They vary widely in scope and size, but almost always focus on projects with a clear social impact. They mostly provide preferential debt, but also frequently supplement this with grants and technical assistance. Some DFIs are sector specific, such as the Apex Microenterprise fund, and some are targeted at certain regions or demographics.

BOOKS OF HOPE

Impact investment funding in South Africa

Background

Books of Hope is part of the South African Depression and Anxiety Group. It produces speaking books to educate partially illiterate populations on various topics. The books were the idea of SADAG founder Zane Wilson, who noticed the need for easily accessible materials for illiterate populations during rural fieldwork. Today Books of Hope is the only major global producer of speaking books, and has produced over 50 titles to be distributed across Africa, India and the United States.

Financing history

Around 50% of Books of Hope's funding is covered by sale of the books which are commissioned by governments, corporations, DFIs and international institutions (such as the World Bank) on specific topics. After an aggressive campaign pitching the idea to potential funders, Ms. Wilson obtained funding from DeBeers, the South African Government and the World Bank, among others, to produce the books.

Acumen Fund

Books of Hope approached the Acumen Fund through a contact in Washington D.C. in 2007. After meeting with them, Books of Hope was put through Acumen's rigorous due diligence process, which scrutinized their business plan to assess the profitability, sustainability and scalability of the venture. Books of Hope was given a patient capital loan of $150 000 to allow it to travel and market its product worldwide, an activity that many conventional grants will not cover. Books of Hope keeps in close contact with Acumen and provides it with recent financial and social metrics around the penetration of its products. Acumen provides mentorship to its portfolio organizations, including Books of Hope, which included convening a recent conference in Kenya where they could exchange experiences and learn best practices.

KEY TAKEAWAYS

- Impact Investment funds are available to South African organizations, but are often targeted elsewhere because of the relatively mature funding environment in South Africa. Projects receiving impact investment funding must, like Books of Hope, have an innovative project with a proven high social impact, and sometimes applicability outside South Africa.
- Some social enterprises choose to develop a revenue generating activity without establishing a new for-profit organization.
- Patient capital providers can be as useful as networking hubs and disseminators of best practices as they are as providers of finance.

Some DFIs only provide funds to municipalities or government intermediaries. These have been omitted from the guide since they cannot directly finance your organization. Some DFIs (known as regional development corporations) focus on specific provinces.

Enterprise Development Intermediaries channel money from corporations and DFIs into small and medium enterprises, either in the form of debt or equity. These are also known as Retail Finance Intermediaries.

Socially Responsible Investment Funds channel money from pension funds and other sources into investments that are deemed socially responsible. The database lists only those that have invested in social enterprises. Investments tend to be in large enterprises with fairly high growth potential.

Private Equity Funds purchase equity, often a controlling stake, in organizations that they perceive to have high growth potential. The database lists only those that focus on social enterprise to some degree. In general, only very large organizations can access these funds.

Impact Investing Funds specifically target social enterprises, and tend to make smaller investments than traditional PE funds. These usually consist of patient capital. They often provide expertise and other technical assistance as well.

Venture Philanthropy Funds provide grants to high-potential social enterprises. These funds usually target specific sectors and regions, and usually have high standards for the social and environmental impact and its reporting.

Social Venture Capital Funds are a form of financing for a company in which the business gives up some level of ownership and control in exchange for capital over a limited time frame, usually 3-5 years. The return of the venture capitalist financing is typically through an initial public offering (IPO), where a company is sold on a public stock exchange, or the acquisition of the company.

Grant Issuers are government or non-profit trusts that distribute grants to organizations within their specific areas of interest.

Other Sources not included in the database:

Government Departments will often have funding available for programmes that fit their remit. For example, the Department of Agriculture has funded a social enterprise's sustainable farming initiatives, and the Department of Social Development has funded another's job-creating publication.

Local Government, especially city and provincial governments will also have funds available for certain types of initiative.

For both of these government sources, it is best to research the departments that are most relevant to your organization's sector or geography, and then contact your local representative.

Sector-Specific Funding is available in many industries, often through major corporations or charitable trusts (see the Big Issue SA case study).

Angel Funders are private individuals, usually of high net-worth, who want to provide loans to or take equity stakes in individual businesses. These are often smaller than the equity stakes that funds or venture capitalists will demand. Some will provide expertise or will want a say in the management of the business, while others will remain hands-off. Some angel investors want a certain social or environmental impact from their investment, which may make your social enterprise attractive to them. However, since they are concentrating large percentages of their wealth in one business, they will often expect high returns on investment in return for this high level of risk. Angel investors are often identified through your network, or through intermediaries such as Schwab or Ashoka, but there are also websites, which are listed in the database, that link willing angel investors, for a fee, with projects. Networking events or industry conferences can be good ways to identify potential angel investors.

What returns are expected by different finance providers?

Beyond grants, the most appealing source of finance for social enterprises is patient capital. Whether in the form of debt, equity, mixtures of the two, or convertible vehicles that only require payback when the business is succeeding, patient capital allows social enterprises to develop market discipline without having the pressure of generating the sort of profits and returns on investment that are demanded of purely profit-seeking businesses.

On the left of the spectrum, depicted in Figure 5.1, are financiers that expect no payback of their money. This would include donors and grant-makers. On the right are conventional lenders and investors, who expect at least market returns, which can currently be generalised as being in the region of 10% per year in South Africa. Many equity investors and venture capitalists will expect higher returns than this, often 12%-15% or above. Your organization will have to grow faster than this if it wants to re-invest any profits back into the business. In the middle are patient capital providers. Some provide soft loans where only the principal, or a percentage of the principle, must be paid back.

Others will provide preferential debt, where the interest rate is below the market or prime lending rate, or unsecured loans that require no collateral.

However, these patient capital sources are scarce, especially in South Africa. Grants are relatively common, though not easy to obtain. Large private equity funds exist for high-growth opportunities, and commercial debt finance is widely available for low-risk projects. Patient capital is far less abundant. This is partly because the impact investment industry is so new. While funds for impact investing and patient capital are expanding rapidly, many do not cover South Africa. This means that for many social enterprises the best funding solution, in the short term, may be through a combination of the more traditional types of finance. An exception is enterprise development funding, which often takes the form of soft loans, preferential debt or discounted goods and services. Enterprise Development funds and initiatives are currently by far the largest providers of patient capital to SMMEs in South Africa.

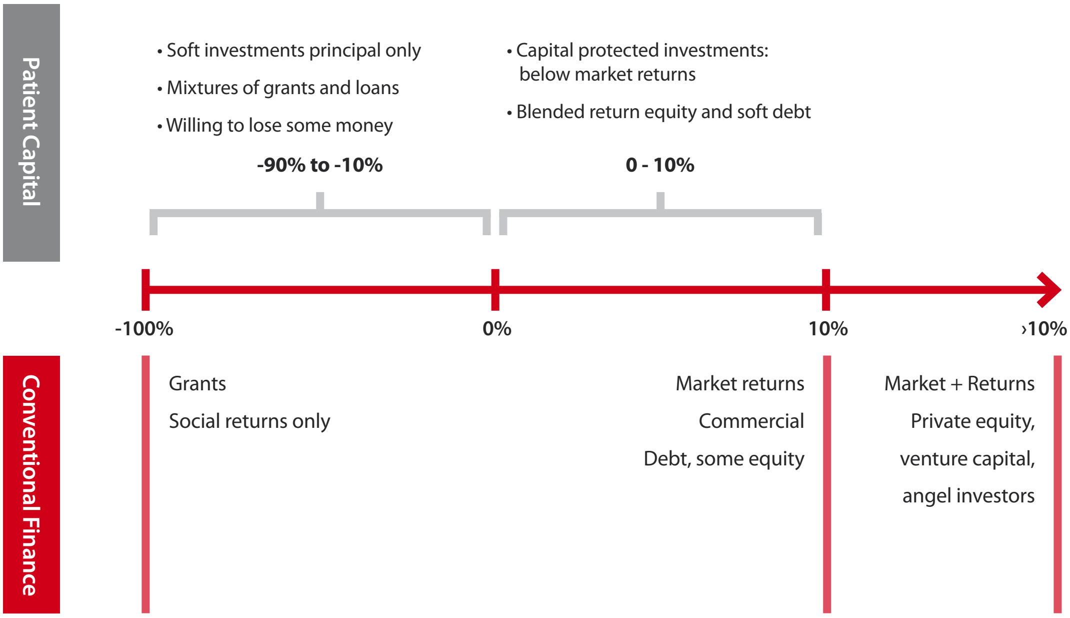

Figure 5.1: Return expectations of different types of finance

6. HOW TO POSITION YOURSELF FOR SUCCESSFUL FINANCING

By now you should understand what type of finance you should be looking for and the organizational qualities and physical documents that you will need to apply for it. All that remains is to get it!

This section will:

- Discuss the importance of networking in obtaining finance.
- Review what different types of finance providers look for in a funding opportunity.
- Explain the due diligence process that many finance providers use when making funding decisions .

Using your network

> *"Constantly create new networks."*
>
> Raizcorp, an enterprise development intermediary

In particular, many of the equity sources in the database are not especially open to cold applications. However, operating through intermediaries (either Enterprise Development organizations or Technical Assistance providers) can help you access some of these funders. When contacting potential investors, it is essential that you have fully thought through your idea, have a sturdy business plan, and have a well rehearsed 'pitch' to sell the idea to the investors.

Networks can be important ways to find out how similar organizations have accessed finance, to identify potential angel investors, or to improve your relationships with potential finance providers. They will then have more confidence in your business and thus be more likely to invest in or lend to it. Many social enterprises use unique networks from their previous careers, educational backgrounds or local communities which they use to obtain monetary and in-kind donations. As examples, in our case studies the **Bulungula incubator** found that visitors to its affiliated eco-lodge were among the most willing and generous donors to its micro-enterprise development programme, while **Township Non-Profit** used its links to the French community to access funding from large French corporations operating in South Africa.

CASE STUDY 7

THE BIG ISSUE SA

Accessing sector and region-specific funding

Background

Based on the UK publication with the same name, The Big Issue South Africa produces a magazine every three weeks which is sold around Cape Town by over 400 vendors. The vendors are previously long-term unemployed and disadvantaged individuals, and The Big Issue SA, in addition to providing them with a stable income, also offers counseling and skills training to help the vendors find secure long term employment in the future.

Financing history

The Big Issue SA was launched in 1996 and is incorporated as a Section-21 company. It earns around 45% of its revenue from the sale of the magazine and associated advertising/promotional revenue. Today its main sources of funding are the Dutch DFI Cordaid, which has provided it with a grant of €290 000 over six years to help cover overheads and publishing costs, and the National Lottery Distribution fund, which has supported the organization since 2000 and provided R915 000 in grants in 2009-10.

Sector and Regional Sources of Funding

As an organization with a strong social message and a proven model, The Big Issue SA does not want to accept funding that requires it to deviate from its principles or operating model. It has found that many of the most accommodating funders have been those within the media industry, and has also accessed significant funds from various local authorities within the Western Cape. The initial feasibility study for the publication in 1996 was funded by the Western Cape Provincial government, and today the enterprise receives grant funding from the Western Cape Department of Social Development, to the tune of R374 000. It has had additional support over the years from the City of Cape Town municipality. It has also accessed funding targeted at media and publication organizations, including a grant of over R450 000 from the Media Development and Diversity Association to help with marketing and publishing, a R250 000 grant from the Open Society Foundation to help improve their product and provide skills training to beneficiaries, and a grant from the DG Murray Trust to purchase a new vehicle for community and street work.

KEY TAKEAWAYS

- Social enterprises can obtain funding from sources specific to their sector and geography. Often these sources have priorities that are more in line with the mission of the organization.

What do finance providers look for?

Grant-makers look for projects that meet their priorities. These tend to be based on the social or environmental impact of the project. Often, these priorities are sector or geography specific, and are usually publicly available on their websites or publicity materials.

A social enterprise applying for grants should focus on its beneficiaries, and explain how the positive impacts that they enjoy are a direct and measurable result of the project. Grant applications should use language and content that matches the specific aims of the donor organization, while remaining honest about the work that the enterprise does. Venture philanthropists, and other grant-providers that use an investor's mindset, often insist on more rigorous, quantified and long term assessment of social and environmental impact. Thus, having a good idea of your measurable impacts, and of how they can be accurately measured, is a crucial prerequisite to applying for funding from any of these providers.

Debt issuers will focus on the risk of the project when assessing whether to issue debt, and deciding on the interest rate. The determination of risk is based on the inherent risks of the project either succeeding or failing, as assessed by the potential investor, as well as the cash reserves and collateral that you may be able to provide to reduce the risk to the lender.

Enterprises seeking debt financing should, therefore, demonstrate a strong understanding of the likely future costs and revenue streams of the business. In addition, they should be able to discuss organizational and external risks that the business faces, and how these might be mitigated.

Equity investors also consider risk. Since, in the event of a bankruptcy, equity investors are paid after lenders, their risk is higher, and they may therefore expect a higher rate of return than a lender. However, they often have longer time horizons, making them more patient, and they may expect to make most of their money through selling their stake in the future, rather than through dividends.

> *"Understand exactly what it is the funder wants out of a proposal and make sure your objectives are the same - otherwise you're wasting your time. Also, if you're turned down, find out exactly why so you can improve on your proposal next time"*
>
> Connect Africa, a rural IT provider

Equity investors will often want to know the existing financial obligations of an enterprise to ensure that their stake, and commensurate expectation of returns, does not put an unreasonable amount of strain on the enterprise's finances.

When applying for equity, it is crucial that your organization matches the profile of the fund you are applying to in terms of size, sector and geography, as well as other factors. You must also determine the valuation you have of your company. This is often described by venture capital and private equity funds in terms of a multiple of your profits or earnings ratio. You must also consider what return you can realistically offer on any investment, and the amount of control you are willing to give an investor in the business. This will correspond to the amount of equity you are willing to sell. Finally, you should identify potential exit options for the investor to reassure them that they will be able to sell their equity in the future. This can be a struggle for social enterprises. One option would be for management to re-purchase the equity from the investor once the business has larger reserves and is more profitable.

Socially oriented lenders or investors will consider the risk, the financial reward and the socio-economic impact of the project when making financing decisions, and will have their own ideal mix of these three factors. Be sure to understand the area of social impact that a grant maker or impact investor is looking to invest in, and tailor your pitch to that investor to emphasise aspects of your programme that fall into that area.

Equity applications have a low success rate. Only a tiny fraction of venture capital, private equity or SRI proposals result in an investment, and it is common to not even hear back from equity investors.

All potential finance providers will want to see evidence that your organization understands the business risks, and that it has a sensible and realistic plan for coping with any adverse events. One way to provide this is to include SWOT (Strengths, Weaknesses, Opportunities, Threats) analysis within your business plan.

Typically finance providers are quite open about their decision making process, and will provide you with information on their websites.

How do finance providers make their decisions?

Each provider will have its own process for assessing and approving finance. In particular, impact investors and other providers of social finance will often have their own ways of assessing and quantifying social and environmental impact.

Most traditional grant providers follow a competitive grant process, in which they issue a 'call for proposals'. This involves filling out an application form, writing a proposal of the project you intend to initiate, and providing supporting documentation. These processes are fairly self-explanatory. Decision-making processes for these are usually described as part of the call for proposals.

Debt and equity providers follow a very different, and often less rigid, procedure to determine who to fund. This is usually known as a **due diligence process.** The focus is on determining whether the applicant business has the market, model, management and planning required to grow and deliver social impacts rather than on selecting the most qualified from a pool of applicants.

Each finance provider will follow its own due diligence process. However, most decision-making processes follow a similar formula:

The first stage is usually a desk review, where the provider screens applications for basic eligibility and decides whether to look at the application in more detail. Providers may request additional information in a phone interview, such as specific market research, details of other banking relationships and other providers of grants, invoices or lists of contracts and customers, and information relating to suppliers and the amounts owed to them (accounts payable).

Applications that make it past the desk review will come under a more in-depth investigation. This is the main component of 'due diligence' and usually involves a site visit to your enterprise, where various qualitative and quantitative factors will be assessed:

Qualitative factors

- The finance provider will assess management capacity by questioning management about how they run the business, and how they would respond to risks such as loss of personnel, funding or customers. Sometimes the provider will require certain skills or employees, such as a chief financial officer or marketing manager, before issuing funding. It is important to demonstrate that you have a strong and relevant base of contacts in the industry.
- Governance will be assessed by looking at board meeting minutes and shareholder agreements to determine what legal requirements the enterprise has regarding financing.
- The operating environment will be assessed to ensure that your enterprise has adequate staffing, facilities and information systems to cope with the plans outlined in your business strategy.

Quantitative factors

Financial documents

- Up to date financial statements
- Lists of fixed assets that may be used as collateral
- Copies of any lease agreements
- Schedule of non-recurring or once-off costs over the past three years

Funding

- Listing of all other debts, including the balance amount, lender name, interest rate and terms and conditions
- Shareholder names, affiliations, shares held and percentage ownership
- Description of all grants received, including financial and in-kind donations

Business plan and market

- Three to five year financial projections
- Description of all products and services offered
- Projected revenue growth for each product and service offered
- Brochures which describe products and services to clients
- Copies of sector research or data
- Description of the current and future geographic area being served

Financial checks

The key question for providers of debt will be, "Can the enterprise repay the loan in the specified time?" Several financial indicators will help provide them with information to answer this question:

Operational

- **Working capital:** Is there enough money to pay expenses while waiting for grant funding or sales income to be received?
- **Self sufficiency:** To what extent are expenses covered by income earned from the sale of goods and services, and how is this expected to change in the future?

Application
Application in reviewed against basic assessment criterial

Initial Project Review
Initial assessment

Due Diligence
In-depth on-site evaluation of all information to verify information supplied by applicant

Terms & Conditions
Preparation/negotiation of terms reflecting key understandings

Internal Approval
Presentation & motivation to Investment Commitee

Contracting
Drawing up of legal agreements and signing thereof

Disbursement
After all conditions precedent of been met, the funds may be drawn down as per agreed milestones

Figure 6.1: Application Process for the National Youth Development Agency

Cash flow

- **Liquidity:** Is there enough cash to meet operational needs?
- **Debt service coverage:** Can your business service existing debt and what is its capacity to take on new debt?

Capitalisation

- This refers to the way that a business's assets are funded. Although this usually refers to debt and equity, assets funded by grants are also considered capitalised because of stipulations and conditions which could result in the loss of the grant. In particular, finance providers will want to see the ratio of debt to equity in the capitalisation of assets. Because equity holders are paid after creditors, having a large percentage of equity in your capitalisation is desirable for lenders. However, shareholders will want a higher percentage of debt (although not an unsustainable amount), as this will increase their return on equity as it is split between fewer people.

Revenue analysis

- Sources: How secure are revenue sources? Are they likely to grow or shrink in the future? Are grant funders likely to continue their support?
- Diversity of sources: The more diverse the revenue streams of an organization are, both in type and in number of sources, the lower the risk is considered to be.

Security

- Loan to value of property: this will assess whether property or equipment offered as collateral has sufficient value to pay off the debt.

Trend Analysis

- Providers will look for long term improvements in:
    - Cost/income ratio (profitability)
    - Self sufficiency (reliance on grants)

After due diligence

If finance providers approve funding, they will enter into negotiations with your enterprise to determine the nature and terms of the funding. This will include the quantity of funds that they will provide, the length of time required for repayment, the specific type of debt being issued, and the interest rate (debt) or price per share (equity). Conditions for drawing down funds will be stipulated. These will often include shareholder approval, verification of licensing and registration of the enterprise, and project specific conditions such as the involvement of another funder, government approval of a contract etc. **Covenants** will also be stipulated to ensure that repayment is possible. These often include a requirement to remain in the same line of business and not to sell key assets.

It is important to carefully consider the restraints that terms of financing may impose upon you, especially in terms of successfully securing finance in the future. Defaulting on payments or breaching conditions can have disastrous consequences for your organization's credit rating. Reading and understanding the fine print on loan agreements is vitally important, and may require the help of a legal professional.

Once the terms, conditions and covenants have been agreed upon, the provider will obtain final approval. It may be advisable to have a lawyer review the contract before signing it.

A note on timing

Applying for finance is a laborious experience that can take months. Once applications are submitted and supporting documentation has been obtained, there is an additional wait for the response of the finance provider and a further lag time between securing funding and having it physically deposited in your account.

> *"Cash-flow management is the linchpin of sustainability."*
>
> Nurcha, a construction finance company

You should be aware of long lead times between applying for and receiving finance, which are often much longer than the finance providers state themselves. It is crucial that your enterprise has cash available to cover operating expenses while you go through the financing process. Applications for finance must be submitted well in advance of the time that the money is actually needed.

TOWNSHIP NON-PROFIT

Finding funding through your network

Background

Started in 1997, Township Non-Profit now contributes R2 million to the township economy and employs 70 people. It is separated into a non-profit Section 21 called "Afrique du Sud Bidonvilles" (reflecting the French stock of the founder), which trains co-operatives and provides them with subsidized machinery to become economically productive. The co-operatives produce bags for the for-profit "Township Patterns", which markets and sells them through Pick n Pay, business conferences and the fashion industry.

Financing history

As with most of our other case studies, the initial funding for the enterprise came from founder Nicole Iresch's personal funds, and those of friends and relatives. Today, Township Non-Profit has a well-diversified funding model. The for-profit venture sustains itself on the sale of bags, which generated R8 million of revenue in 2009. It uses a line of credit facility which is offered by the British-based "Shared Intent", and allows them to withdraw up to $250,000 on an unsecured basis at market rates of interest. This facility is only available to members of the World Fairtrade Organization.

The for-profit donates 2% of its sales to the non-profit, covering about 15% of its running costs. Another 15% is provided by fundraising events, 5% through in-kind donations, with the remaining 65% being donated by grant providers. The non-profit has received funding from Eskom and the DTI, as well as grants from the Pick n Pay Foundation and Ernst and Young. It recently listed on the South African Social Stock Exchange (SASIX), which allowed it to raise R690 000.

Using your network: the French connection

Township Non-Profit offers an excellent example of how to leverage your network to find financing, publicity and customers. In this case, the French roots of the owners became important conduits for funding. During the launch phase of the enterprise, Nicole approached a number of companies with her needs, and asked if they could help. She received funding from her previous employer, Air France, and a vehicle from Renault. Township Non-Profit has continued to enjoy support from the French community, with recent grants from solar panel producer Tenesol and oil company Total. A recent visit by French first lady Carla Bruni-Sarkozy allowed the enterprise to make and sell several hundred commemorative bags.

KEY TAKEAWAYS

- Using your network, either through career or cultural connections, can be a good way to access money and in-kind donations during the launch phase of an enterprise.
- Using a non-profit as a supplier can allow grant-subsidised inputs to your enterprise while maximizing social impact.

Summary

THANK YOU FOR READING

If you are to take anything from this guide, it is that your search for finance should be systematic, well planned and well-targeted. The only thing worse than having application after application rejected is the knowledge that you have wasted thousands of Rand and hundreds of hours writing those applications.

Making sure that your organization is properly run, has prepared all the necessary material and is looking for the right types of finance through the right channels can help minimise, though not eliminate, this anguish. Examine the following checklist to determine whether your social enterprise is ready to search for finance.

CHAPTER	KEY LEARNING
2	I know how to classify my organization in a way that matches the funding categories of finance providers.
2	I understand the implications of my organization's legal and BBBEE status, and am looking for the types of finance that prefer this status.
3	I have a clear idea of the unique competitive advantage of my organization, and have translated it into an operational model that is realistic and, eventually, profitable, making me an eligible candidate for finance.
3	I have already used all of the immediately available finance sources that I can access, including personal funds, community amenities and resources, and local monetary and in-kind donations. I know, therefore that I need to be looking for external finance.
3	I have a compelling social enterprise business plan, which incorporates the necessary financial elements (including a strategic plan, key financial statements, market research and competitive analysis) and social elements (including a problem statement, mission, vision, theory of change and a plan for impact measurement).
4	I understand the key features, advantages and pitfalls of grants, debt, equity and patient capital.
4	I am familiar with the various types of grants, debt and equity, and know which type is most appropriate for my financing needs and organizational stage of development.
5	I know who provides the type of finance I am looking for in South Africa.
6	I understand what finance providers look for, how they make their decisions, and how to use my network to maximise my chances of success.

7. GLOSSARY, BIBLIOGRAPHY AND RESOURCES

While we have done our best to simplify the complex and often bewildering process of looking for finance, there will inevitably be questions you have that remain unanswered. The next section, which lists many online sources of information and providers of technical assistance, should help to answer those questions.

Glossary

Access Bond
Type of loan where you can take out amounts that you had previously repaid for the same interest rate.

Asset
An item of value owned by your business, including cash, stock, property, machinery, patents.

Balance Sheet
Statement of financial position showing what your enterprise owns (assets) and what it owes to lenders (liabilities) at any given point in time.

Broad- Based Black Economic Empowerment (BBBEE)
South African government policy designed to economically empower disadvantaged groups. It includes an emphasis on Enterprise Development (ED) and Socio-Economic Development (SED), which provide potential funding sources for qualifying social enterprises.

Capital
Money that is used to make profit.

Cash flow
The short term inflows and outflows of money in your enterprise. The cash conversion cycle refers to the process of purchasing inputs, producing your product, selling your product and receiving payment for your product. This can take some time.

Collateral
Any asset that is used to secure a loan or credit, and to which the lender is entitled if the borrower does not repay the debt as agreed

Convertible Grant/Loan
An instrument used by providers of patient capital. Convertible grants and loans require repayments or equity only if the enterprise is succeeding and growing above a certain level. They can be structured in many different ways.

Covenant
In this context, these are commitments or assurances that an enterprise makes when agreeing to finance. These might include providing financial statements, continuing in the same line of business, and not selling key assets.

Debt
This is borrowed funds from lenders; the borrower pays interest for the use of the funds and is obligated to repay the principal amount on a set date.

Debt to Equity Ratio
The percentage of your business that is financed with debt versus equity. In general, the higher the relative proportion of equity, the more financially secure the business is.

Development Finance Institutions (DFIs)
Domestic or international organizations that provide funding to enterprises, municipalities or organizations that are specifically advancing development goals.

Due diligence
Refers to the process of making sure that someone is what they say they are and can do what they claim they can (e.g. does the product really work, do they really have customers, etc.)

Equity
Companies can sell their equity to investors in exchange for receiving investment funds. Selling equity is essentially selling a percentage of the company's ownership. In accounting terms, it is the residual claim or interest of the most junior class of investors in assets, after all liabilities are paid.

Enterprise Development (ED) - See BBBEE

Exit Option
Way for an equity investor to sell her stake and end involvement with the enterprise.

Factoring
A finance option whereby the bank collects invoices from your customers and advances you the payments for a fee.

For-profit company
A public or private organization that is allowed to distribute profits to shareholders or directors.
Grants - Awards of money that do not need to be repaid.

Impact Reporting
The process of recording and accounting for the social and financial activities of an organization against predetermined targets and /or standards.

Initial Public Offering (IPO)
The initial listing of stock in an enterprise on a regulated exchange.

Interest
The price paid for the use of borrowed money, or the money earned by deposited funds. The interest rate is the percentage of the principal (initial borrowed/invested amount) that is repaid over a certain period of time e.g. monthly, quarterly, annually.

Invoice-discounting
A type of loan where, for a fee, the bank will advance you the money that your customers owe you but have not paid yet.

Liability
An amount owed by the enterprise, including monies owed to suppliers and debts to lenders.
Market rate - The interest rate at which borrowers are willing to pay and lenders are willing to earn for a certain debt obligation, taking in to account its risk level.

Mezzanine finance
A financing instrument that combines debt and equity.

Mission
The specific purpose of a social enterprise, which outlines the activity that it will engage in to address a societal or environmental issue.

Non-profit
A company or other form of organization that may not distribute profits to shareholders or directors, and may not issue equity.

Patient capital
Traditionally associated with equity-type investment within the private sector, it is being interpreted within the social investment space as 'mezzanine-type' finance that is a stage between a grant and a loan. With patient capital, the investor is willing to make a financial investment in a business with no expectation of turning a quick profit. Instead, the investor is willing to forego an immediate return in anticipation of more substantial returns later.

Principal
A sum of money owed as debt, upon which interest is calculated.

Private Equity
An asset class that encompasses securities of companies that are not listed on a public exchange. It generally includes venture capital.

Public Benefit Organization (PBO)
Any organization which carries on a public benefit activity and is either:

- a company incorporated in the Republic under section-21 of the Companies Act, 1973;
- a trust formed in the Republic;
- an association of persons established in the Republic; or
- a branch established in the Republic by a charity which has been formed in terms of the laws of any country outside the Republic and which is exempt from income tax in such other country.

Quasi-Equity
A category of debt taken on by a company that has some traits of equity, such as having flexible repayment options or being unsecured. Examples of quasi-equity include mezzanine-debt and subordinated debt.

Retail banks
Commercial finance institutions that interact directly with consumers rather than corporations or other banks. In South Africa, the main retail banks are ABSA, FNB, Nedbank and Standard Bank.

Return on Investment (ROI)
The profit or loss resulting from an investment, usually stated as a percentage of the original investment amount.

Section 18a organization
A legal category in South Africa. Individuals or organizations donating to Section 18as are exempted from donations tax.

Section-21
A common legal incorporation for non-profits in South Africa. A section-21 Company must have a minimum of two directors, which aids accountability, and seven subscribers to appoint the directors. Auditors have to be appointed. 70% of the income of the company must be allocated to the object of the business, which is normally a community based business initiative. The directors may however draw reasonable salaries. No assets or properties can be sold but can be donated to a similar organization.

Security – see Collateral

Small, Medium and Micro-Enterprises (SMMEs)
This catch-all term refers to any business that is not a large corporation. In South Africa the National Small Business Amendment Act of 2003 contains sector-specific definitions of what constitutes an SMME, and what constitutes a small, medium or micro business, but generally these stipulate an employee ceiling of between 5 and 200, and turnover ceiling of between R100,000 and R20 million.

Social enterprise
An organization that has a market orientation but exists to address a social or environmental issue.

Socially responsible investment (SRI)
A growing subset of investing which incorporates environmental, social and governance factors into investment decisions. SRI funds now channel billions of Rand into responsible and social enterprises.

Socio-Economic Development (SED) - See BBBEE

Sustainability
The ability of an organization to continue financing its operations and providing positive impact in the future.

Subordinated debt
Debt that, in the event of a bankruptcy, would be paid out after other forms of debt. It is often unsecured, and as used as a form of patient capital.

SRI - see Socially responsible investment

Theory of change
A description of how the functioning of your social enterprise will bring about the positive changes described in your mission and vision.

VC - see Venture capital

Venture capital
A form of financing for a company in which the business gives up some level of ownership and control of the business in exchange for capital over a limited time frame, usually 3 to 5 years. The return of venture capitalist financing is typically through an initial public offering (IPO), where a company is sold on a public stock exchange, or an acquisition of the company.

Vision
A description of the world that your social enterprise seeks to help create.

Bibliography

We are grateful to the authors of the following documents.

Getting Business Finance: A Guide.
2nd. Johannesburg, South Africa: National Youth Development Agency, 2010. Print.

Handford, Penny. *Guide to Financing for Social Enterprises.*
1st. British Columbia, Canada: Western Economic Diversification Canada, 2005. Print.

New Economics Foundation, and Shorebank Advisory Services. Unlocking the Potential: a guide to finance for social enterprises.
1st. London, England: Social Enterprise Coalition, 2004. Print.

No-Nonsense Guide to Finance for High-Growth and Innovative Businesses.
2nd. London, England: Business Link, 2009. Print.

Shortall, Jessica. *Introduction to Understanding and Accessing Social Investment: A Brief Guide for Social Entrepreneurs and Development Practitioners.*
Seep Network and Virtue Ventures, 2009. Print.

Wuttunee, Wanda et al. *Financing Social Enterprise: An Enterprise Perspective. Linking, Learning, Leveraging.*
1st. Ontario, Canada: Social Science and Humanities Research Council of Canada, 2008. Print.

Resources

Business Plan Guides

NYDA business plan guide:
www.nyda.gov.za/images/stories/documents/Career%20Guidance/Study/FactSheets%20and%20Guides/Self%20Employment/Guides/Entrepreneurship_Writing%20a%20Business%20Plan_NYDA.pdf

Business Plan e-book (SA):
southafrica.smetoolkit.org/sa/en/content/en/5307/CREATE-A-BUSINESS-PLAN-DOWNLOAD-THIS-BOOK-NOW-

Business Partners Guide (SA):
www.businesspartners.co.za/BusResources/BusPlan.htm

Other Social Enterprise Finance Resources

African Social Entrepreneurs Network (ASEN) Toolbox:
www.thedevelopmentexchange.co.za/ToolSearch.asp?Browse=Yes

Business Link Social Enterprise Toolkit (UK):
www.bllondon.com/SocialEnterprise/Businesstoolkit/SEBusinessToolkit.aspx

Guide to Business Finance from ABSA Bank:
www.absa.co.za/absacoza/content.jsp?/Home/Business/How-Do-I/Start-a-Business/Small-Business-Toolbox

NYDA: Getting Business Finance:
www.nyda.gov.za/images/stories/documents/Career%20Guidance/Study/FactSheets%20and%20Guides/Self%20Employment/Guides/Entrepreneurship_Accessing%20Finance%20GuideNYDA.pdf

SME toolkit:
southafrica.smetoolkit.org/sa/en

Standard Bank Capital Handbooks:
www.standardbank.co.za/portal/site/standardbank/menuitem.042bffe99ebb1a3d63b1a0103367804c/?vgnextoid=9e697bdf5703b110VgnVCM10000050ddb60aRCRD

Social Impact Reporting

Tools and Resources for Assessing Social Impact (searchable database):
trasi.foundationcenter.org/

Crafting a Theory of Change

www.theoryofchange.org/index.html

Information on Legal Forms

CIPRO (government agency):
www.cipro.co.za/products_services/companies.asp

Technical assistance

Small Business

Red Door Small Business Centres (Western Cape):
www.capegateway.gov.za/eng/your_gov/13464

Small Enterprise Development Association (SEDA):
www.seda.org.za/Pages/Seda-Welcome.aspx

South Africa Women's Entrepreneurs Network (SAWEN):
www.dti.gov.za/sawen/sawenmain.htm

The Business Place:
www.thebusinessplace.co.za/default.aspx

Social Enterprise / Entrepreneurship

African Social Entrepreneurs Network (ASEN):
www.asenetwork.org

Ashoka Entrepreneurs Network:
www.ashoka.org

Endeavor South Africa:
www.endeavor.co.za/

Heart Global:
www.heartglobal.org/

Schwab Foundation:
http://www.schwabfound.org/sf/index.htm

Technoserve:
www.technoserve.org.za/team.htm

UnLtd. South Africa:
www.unltdsouthafrica.org/

Enterprise Development Assistance for Businesses:

BEE-related: BEESA:
www.beesa.co.za

Raizcorp:
www.raizcorp.co.za

Relativ:
www.relativ.co.za

Shanduka Black Umbrellas:
www.blackumbrellas.org

Academic/Research Institutions

Centre for Development and Enterprise:
www.cde.org.za/page.php?p_id=1

Finmark Trust: Inclusive Financial Markets for South Africa:
www.finmark.org.za/new/pages/default.aspx

Gordon Institute of Business Science (GIBS) Social Entrepreneurship Programme:
www.gibs.co.za/programmes/certificate-programmes/social-entrepreneurship-certificate-programme-secp.aspx

University of Johannesburg Department of Entrepreneurship:
www.uj.ac.za/EN/Faculties/management/departments/Entrepreneurship/Pages/default.aspx

PROVIDERS OF FINANCE

For a printable database of potential providers of finance to social enterprises in South Africa, go to

www.saiin.co.za/financeproviders

In South Africa and worldwide, new forms of social purpose businesses are emerging. These social enterprises often fall between the cracks, being neither traditional non-profit organizations nor conventional businesses, and find it hard to access appropriate financial services. But just like any business, they need access to capital to fund their operations and growth.

The Guide to Finance for Social Enterprises is a collaborative effort between the International Labour Organization (ILO) and GreaterCapital, supported by Cadiz Asset Management and Noah Financial Innovation.

It has been developed as part of a series of publications that seek to promote social economy enterprise development in South Africa.

International
Labour
Organization

GREATER GOOD

GREATER CAPITAL

INTERNATIONAL LABOUR ORGANIZATION

Crestway Block C
20 Hotel Street, Lynnwood 0081
PO Box 11694, Hatfield 0028, Pretoria

t. +27 (0)12 818 8000
f. +27 (0)12 818 8087
e. pretoria@ilo.org
w. www.ilo.org/pretoria

GREATERGOOD GROUP

First Floor Block A, Richmond Centre
174-204 Main Road, Plumstead
Postnet Suite 293, Private Bag X16,
Constantia 7848, South Africa.

t. +27 (0)21 762 7944
f. +27 (0)21 762 7065
e. info@ggsa.co.za
w. greatergoodsa.co.za