Market Report 2016
From momentum to implementation

Bertelsmann Stiftung
SOCIAL IMPACT INVESTMENT IN GERMANY:
From momentum to implementation
The publication series entitled *Social Impact Investment in Germany* is based on the work of the National Advisory Board (NAB), a cross-sectoral panel of experts coordinated by the Bertelsmann Stiftung, whose purpose is strengthening the market for social impact investment (SII) in Germany. The National Advisory Board received its original mandate from the Social Impact Investment Taskforce (SIITF), which was established during the UK’s presidency of the G7 in 2013. The Taskforce, along with the National Advisory Boards of the G7 Member States, were mandated to formulate recommendations for the constitution and further development of international markets in which supply and demand for social impact investment capital could be effectively brought together.

The German National Advisory Board is composed of representatives from the social, financial and public sector, as well as foundations and academia. In its final report of September 2014 the NAB recommended improving the availability of information on social impact investment in Germany. In keeping with this recommendation, Bertelsmann Stiftung is publishing this series with a view to systematically build knowledge on the supply of, and demand for, capital as well as on market infrastructure in Germany’s emerging social impact investment market.
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Social Impact Investment in Germany: From momentum to implementation

I. PREFACE

Dr Brigitte Mohn

Last year, assets amounting to 68 trillion euro were professionally managed around the globe—by 2020 this figure is set to rise to more than 100 trillion euro. Traditionally, investors seek to maximise the returns on their invested capital, whilst at the same time managing risks. In recent years, however, a new trend has emerged. Investors are increasingly interested in the direct social impact of their investment decisions. For these investors, impact is considered equal in importance to the traditional objectives of a financial investment. As a result, social-purpose organisations aiming to integrate disadvantaged people into the employment market, to improve educational opportunities or to provide preventive healthcare services can access new sources and types of finance. This innovative and inspiring form of financial investment demonstrates that in future, the provision of capital and the achievement of positive social change can be combined in thought as well as in deed.

This aspiration is summed up in the term ‘social impact investment’—an investment strategy that is gaining global traction. The global social impact investment market volume increased by more than 30 percent between 2012 and 2014 to around 11 billion euro. The global focus is particularly on emerging countries: 70 percent of the funds invested in these areas flow into micro-finance, financial services and energy.

However, the need for such capital is not limited to developing countries, as an initiative of the G7 member states that began two years ago demonstrated. Industrial countries with highly developed social welfare systems are also considering the benefits of social impact investment to strengthen existing approaches and develop new ideas. A report issued in 2014 by the German National Advisory Board, coordinated by Bertelsmann Stiftung, showed where the potential for social impact investment in Germany might lie. We found that in particular the development of prevention, the encouragement of innovation and the scaling-up of good, tried-and-tested ideas have the potential to reinforce and expand the capacity of the German social welfare system. The next step will be to test this hypothesis.

As this report clearly demonstrates, social impact investment in Germany is still a niche activity driven by pioneers in the field. However, its dynamic growth is unmistakeable: since 2012 the investable assets deployed in social impact investing in Germany have roughly tripled—from 24 to nearly 70 million euro. An ever-increasing number of specialised intermediaries are creating the basis for more investors and more investees—and ultimately for enhanced social impact. At the same time, we note that suitable regulatory conditions and political will are key factors for the development of this small but promising market. These encouraging developments invite us to continue along the path we have taken.
I would like to extend my particular gratitude to the German National Advisory Board for its support in conceiving and planning this report. I am also grateful to the many other experts and practitioners who have shared their knowledge with us. Their pioneering spirit—in both thought and action—has been the basis for this report.

I hope you will enjoy reading it.

Dr Brigitte Mohn

Member of the Executive Board
Bertelsmann Stiftung
II. KEY FINDINGS

► In the three years since the publication of the last market report, the German market for social impact investment has greatly benefited from national and international market-building initiatives and the increased attention that followed them. This heightened interest generated by a small number of active pioneers and their supporters contributed to the rise in investable impact assets in Germany to around 70 million euro by the end of 2015, representing an almost threefold increase compared to 2012. This development implies a growing annual investment volume in the future, which may reach 7 to 8 million euro in 2016 (an increase of about 60 percent compared to 2015). Despite the termination of the co-financing programme of the Kreditanstalt für Wiederaufbau (KfW), the number of annual transactions has largely remained stable. The structure of the German SII market continues to be heavily influenced by the activities of the two established social venture capital fund managers (BonVenture and Ananda Ventures), which is reflected in the investment focus and the asset classes employed in the market.

► Detailed analysis of the individual market participants (capital supply, intermediaries, capital demand and market environment) demonstrates that the young German SII market is still in an experimental phase and is struggling with major structural shortcomings: a small investor base, few intermediaries with little diversification, a limited number of investment products, few investment-ready impact-driven organisations and continued need for assistance in developing a functioning market environment with advisers and supporters. Overall, market-building efforts and financing are still in the hands of a small number of private and civil-society actors.

► Nevertheless, it is evident that the market has gained momentum since 2012: existing funds have succeeded in raising more money from investors, foundations have become active social impact investors, existing intermediaries are now developing new investment products, more impact-driven organisations are financed through SII and the market environment has stabilised. A particularly positive development is that some of the recommendations of the German National Advisory Board have already been implemented.

► The UK example demonstrates that strategic, coordinated policies and an active role of policymakers are required to systematically develop the SII market. Building a robust and diversified range of intermediaries is key to achieving this goal. Due to their mediating role between supply and demand, intermediaries can attract new groups of investors, create incentives for the establishment and financing of impact-driven organisations and successfully demonstrate the viability of SII.

► Whether the positive momentum we are observing can be used to develop a functioning ecosystem, enabling the German SII market to reach a critical mass within the foreseeable future, will strongly depend on whether German policymakers assume a coordinating and actively catalysing role in the strategic development of the market. In this sensitive growth phase, the state is the only actor that has the required financial resources as well as the legal and political scope for action in order to remove the obstacles to social impact investment and to coordinate and catalyse the
existing initiatives of private actors. Given the need to tap new sources of finance to tackle demographic and social challenges, the German federal government ought to have an inherent interest in assuming this role. Key success factors will be the alignment with existing policies (e.g. in the Federal Ministry for Economic Affairs and Energy (BMWi), Federal Ministry for Families, Senior Citizens, Women and Young People (BMFSFJ) and the Federal Ministry for Economic Cooperation and Development (BMZ)) and the pooling of competencies at the political level in a single specialist agency for social impact investment.
Social Impact Investment in Germany: From momentum to implementation

III. INTRODUCTION

In December 2012 Impact in Motion published a report commissioned by Bertelsmann Stiftung entitled "Impact Investing in Germany — the current situation and guidelines for further development". This report discussed the definition of impact investment for the first time in the German context while offering a comprehensive overview of the actors engaged in this relatively young market.¹ At that time, the German market for social impact investment was still in an experimental phase, with few active pioneers and the relatively small volume of investable impact assets totalling 24 million euro.²

According to the annual Impact Investing Survey published by J.P. Morgan and the Global Impact Investing Network, the worldwide SII market grew by more than 30 percent between 2012 and the end of 2014 to around 11 billion US dollars.³ This is due to increasing interest among investors as well as to numerous national and international market building initiatives, such as the Social Impact Investment Taskforce set up in 2013 under the UK’s G7 presidency and various initiatives by the European Union for the strengthening and financing of social enterprises.⁴

Over the past three years, the German SII market has also benefited from the increased attention being paid to this segment and has clearly gained visibility compared to 2012. Some active pioneers regularly bring new momentum to the market and attract attention to their work. Prompted by the International Social Impact Investment Taskforce, a German panel of experts — the National Advisory Board — was established in 2013. In September 2014 it published strategic recommendations for the growth of the SII market, and it will continue to serve as a platform for the development of the SII market after the expiry of the official SIITF mandate. The large amount of attention and communication regarding the German SII market is also associated with the increased use of German terminology such as wirkungsorientiertes Investieren (rather than Social Impact Investment) and sozialer Wirkungskredit ⁵ (instead of Social Impact Bonds).

Despite the increased attention, the SII market is still a niche in the global financial system, particularly in Germany, where the development of the market lags significantly behind that of markets in the Anglo-Saxon world, such as the UK and the USA. There is an increasing awareness, however, that private social impact capital can be mobilised in a purposeful way for innovation and prevention, areas which are under-financed even in a comprehensive social welfare state such as Germany.⁶ The idea of social impact investing is therefore also attracting increased interest among political leaders in Germany. In addition to the Federal Ministry for Families, Senior Citizens,

¹ Weber & Scheck (2012).
² The investable assets are comprised of assets managed in SII funds (assets under management) as well as investment pledges by foundations.
⁴ For detailed descriptions of the relevant initiatives, see Infobox 1.
⁵ Fliegauf et al. (2015).
Women and Young People (BMFSFJ), which has for years been calling for improved financing in order to promote social enterprises, the Federal Ministry for Economic Affairs and Energy (BMWi) is currently also considering how existing state programmes for supporting business start-ups can be extended to social enterprises. Additionally, the Federal Employment Agency (BA) is evaluating if and how the piloting of Social Impact Bonds (SIBs) for the sustainable integration of long-term unemployed people into the primary labour market can be supported at the jobcentre level.

The need to meet the social and demographic challenges of the future and tap into new sources of finance requires the development of a diversified SII market, in which investors and investees are systematically and efficiently brought together.

**Objective and focus of the report**

The final report of the German National Advisory Board to the Social Impact Investment Taskforce explicitly calls for improvements in the provision of market information through the regular publication of current market data in order to foster growth and efficiency in the German SII market. So far, there is a lack of publicly accessible information about the German SII market. The aim of this report is to fill this gap and to inform both German and international actors about the status quo of the German SII market.

This report focuses on the development of the German SII market since 2012 and analyses various policy options for the German government with regard to promoting its further development.

In addition to a quantitative analysis of the market, the report includes a detailed overview of the qualitative developments in the supply of capital (investors), the intermediaries (channeling capital), demand (investees) and the market environment (advisers and supporters) on the German SII market. Furthermore, the report also investigates the progress of the recommendations set out in the final report of the German NAB published in September 2014 concerning these four areas and provides an insight into the way in which the SII market has been successfully established in the UK since 2000. Finally, the study examines possible roles for the state in the development of the German SII market by virtue of its functions as legislator, impact-driven contracting authority, catalytic investor and guarantor of the quality of impact reporting.

**Methodology and sources of data**

Our report is based on the detailed analysis of German and international market reports as well as annual reports and press releases by the market actors. Quantitative market data was gathered in a detailed survey of investors and intermediaries conducted between June and November 2015 with regard to their investment activities over the past three years. The survey was supplemented by detailed interviews with 17 investors, intermediaries and SII experts. A full list of the interviewees is provided in the annex to this report. The work of producing this report was supported in a
substantial way by the German National Advisory Board, of which most of the interviewees are members. During the NAB meeting in June 2015, the topic of possible roles for policy makers in the development of the German SII market was selected by the NAB as the focal theme for this report.
IV. THE GERMAN SII MARKET AT A GLANCE

4.1. What does social impact investment mean?

The German term *wirkungsorientiertes Investieren*, a translation of the English phrase ‘social impact investment’ (in short, ‘impact investment’), is still relatively new, having first been used in the final report of the German National Advisory Board published in September 2014. It is associated with varying perceptions and definitions. On the basis of the definition established by the Global Impact Investing Network (GIIN), the term social impact investment is used in this report in accordance with the following definition:

*Social impact investments are investments made into companies, organisations, and funds with the intention to generate social and/or environmental impact alongside a financial return. The social and/or environmental impact is part of the investment strategy and is measured.*

Impact measurement and interest-bearing returns on capital are characteristic features of SII

Figure 1 shows how social impact investment is classified in relation to other similar terms. For example, social impact investment differs from socially responsible investing through its explicit setting of impact goals and through impact measurement. Also, the recipients of capital for SII are impact-driven organisations for whom the achievement of social impact is their very business objective. Hence, social impact is at the heart of these organisations and is not merely a by-product of their real business activities. Unlike donations, impact investors do expect interest-bearing returns on the invested capital.

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7 National Advisory Board (2014), p. 11.
9 See section 5.3.
Owing to its close proximity to some forms of socially responsible investing, the term social impact investment is often equated with these forms of investment in Germany. This happens particularly frequently in what are known as *zweckgerichtete Investitionen* (purpose-driven investments), which have a social or environmental purpose as the financing objective but which, unlike social impact investments, do not link this purpose to specific stipulations or with subsequent measurement of the impact. In the case of purpose-driven investments, environmental, social and/or governance criteria are taken into account in the investment decision, along with considerations of risk and return.

Impact measurement as a defining criterion for the SII market is controversial among market participants in Germany since this criterion severely limits the market. In this early market phase, in which there are still many uncertainties regarding the definition and there is a significant latent danger of ‘social washing’, we regard the retention of this criterion to be essential. After all, social impact investing does not mean investing money in organisations that supposedly or possibly generate impact, but rather in those which have been proven to do so.
In principle, social impact investing covers a wide range of investment opportunities encompassing various geographical regions, asset classes and sectors. The focus of this report can be narrowed down as follows:

- The regional focus of this report is on investments in Germany using capital that is managed in Germany.

- Today, social impact investments can be made in nearly all asset classes the world over, including investment structures such as guarantees and hybrid financing. The most common forms in Germany are, however, private investments through the provision of equity or debt capital, which is why they are the focus of this report.

- A further limitation of the market analysis is the exclusion of sectors like SME financing, renewable energy and climate protection in favour of a sharp focus on the financing of impact-driven companies, organisations and projects.

Figure 2 depicts the ecosystem this report will focus on, in accordance with the delimitation of the market set out above. The ecosystem consists of investors who provide capital, intermediaries who mediate between investors and investees, financial products which meet the financing needs of the investee organisations, and impact-driven organisations (e.g. for-profit social enterprises and charitable organisations) as investees.

**Fig. 2: The ecosystem of the German SII market**

Source: own illustration based on the SIITF.
4.2. What is the current state of the German SII market in 2016?

The German SII market is in an early phase of its development; owing to numerous national and international initiatives, the market has gained momentum since 2012.

To date, the idea of mobilising private impact-seeking capital in order to solve social problems has spread most rapidly in Anglo-Saxon countries with liberal welfare states. In Germany, the idea of social impact investing is still relatively new, although the funding pioneer BonVenture has been active in this market for more than a decade.

Although the SII market in Germany first came into being more than a decade ago, our research shows that the German SII market is still in an early phase of its development, in which supply and demand do not come together in an efficient and cost-effective way. Methods and knowledge are spreading only slowly and are concentrated within a small circle of active actors. The slow development in Germany, which unlike the Anglo-Saxon countries has a strong welfare-state tradition, is also due to the fact that mutual adaptation between SII and existing state-sponsored social welfare ideals has yet to take place.\(^\text{11}\)
Furthermore, the development of the market has so far been financed purely through private (mostly philanthropic) funds and supported by a handful of facilitators such as Ashoka, BMW Foundation Herbert Quandt and Bertelsmann Stiftung.

Since 2012, national and international impact investing initiatives have, however, led to significantly increased international interest in this niche financial market, thus also benefitting the German SII market. As shown in Fig. 3, the number of actors has risen considerably during this period.

INFOBOX 1

National and international activities promoting the development of the SII market

The Social Impact Investment Taskforce and the National Advisory Board

The Social Impact Investment Taskforce (SIITF) was established during the United Kingdom’s G7 presidency in 2013. It is made up of state and civil society representatives of the member countries. This independent public-private Taskforce was mandated by British Prime Minister David Cameron to formulate recommendations for the constitution and further development of international SII markets. Germany was represented by Susanne Dorasil from the Federal Ministry for Economic Cooperation and Development (BMZ) and by Dr Brigitte Mohn from Bertelsmann Stiftung. In each of the G7 states, including Germany, National Advisory Boards were created. The German NAB comprised representatives from social enterprises, the financial industry, foundations, academia and the public sector. The NAB informed the SIITF about potentials for further development of the German SII market and formulated recommendations for building the market. In the summer of 2015, the SIITF was converted into a Global Social Impact Investment Steering Group (GSG), in which non-G7 states are also represented. The German NAB has remained in place even after the expiry of its official mandate at the end of 2014, with the aim of continuing to promote the development of the German SII market.

European Union Programmes

The European Union is promoting the development of the SII market by means of three programmes: under the Social Business Initiative (SBI), support is given to social enterprises in Europe, for example through an investment programme featuring specialised umbrella funds. The EU Programme for Employment and Social Innovation (EaSI) also provides support for the social impact investment market. Since 2013 the European Investment Fund (EIF), a subsidiary of the European Investment Bank, has been investing in SII funds via the Social Impact Accelerator Programme. In addition, the EU’s Regulation on European Social Entrepreneurship Funds (EuSEF) has made it possible for investment instruments to obtain certification, enabling fund shares to be sold throughout Europe.

The results of our survey and the analysis of the quantitative data regarding the current state of the German SII market paint a clear picture: as in 2012, the German market remains in an innovation phase, with limited opportunities for investment, and innovations which arise in an uncoordinated manner. Nevertheless, since our last report on the German SII market in 2012, the market has undergone considerable further development and has the potential to grow significantly over the next few years. An overview of the organisations which provided market data is included in the annex.
Investable impact assets are set to almost triple from 24 million euro in 2012 to around 70 million euro by the end of 2015.

The increase in investable impact assets is due primarily to fundraising activities of the two large social venture capital fund managers, Ananda Ventures and BonVenture, which took place during this period.

In addition to the two large funds, the MRI Pilot Fund for Education (Infobox 3) was set up by the expert group on impact investing within the Association of German Foundations (BDS). Furthermore, with the Eberhard von Kuenheim Stiftung der BMW AG, the BMW Foundation Herbert Quandt and the Bertelsmann Stiftung, three large foundations have committed a part of their assets for social impact investment. Some of the impact capital raised by the end of 2015 will, however, also be invested abroad (mainly in Austria and the UK).

Another positive development is the growing proportion of institutional investors. Whereas in 2012 a negligible proportion (less than 5 percent) of the investable impact assets were invested by institutional investors, around a quarter of the capital expected to be raised by the end of 2015 came from this investor group. Active institutional investors include the European Investment Fund (EIF) and, to a much smaller extent, banks with a strong focus on Germany.

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12 Investable assets are calculated as the sum of assets managed in SII funds (assets under management at Ananda Ventures and BonVenture) and investment pledges by foundations (Eberhard von Kuenheim Stiftung der BMW AG, BMW Foundation Herbert Quandt, Bertelsmann Stiftung); the BonVenture III fund is still at the fundraising stage and has been taken into account with the capital of first closing (13.2m euro).

13 BonVenture is still at the fundraising stage; the BVIII fund has been taken into account with the capital of first closing (13.2m euro).
The annual number of transactions has remained largely stable over the past few years. However, several indicators point to a positive development from 2016 onwards.

According to our calculations, the number of annual SII transactions with deal volumes of at least 100,000 euro remained largely stable at around 12 to 15 transactions between 2013 and 2015. The annual transaction volume depends very much on the activity of a few actors (intermediaries or investors), so that a relatively small amount of activity on the part of a single actor (e.g. through fundraising for a new fund or through internal realignment) has a major effect on the market. Over the past three years most of the SII intermediaries that we investigated experienced such a process. This had a dampening effect on market activity even though new intermediaries and investors invested in the market during this period, as did the termination of the KFW programme for the co-financing of social enterprises at the end of 2014. From the beginning of 2016 on the other hand, a significant increase in transaction volume is to be expected owing to the closing of two new funds (MrI Pilot Fund and BonVenture III Fund) in 2015 and the launch of the Early-Stage Co-financing Fund of the Financing Agency for Social Entrepreneurship (FASE).

A further indication of positive development is the reduction of the market concentration compared to 2012. In 2015, the transactions of the two large social venture capital fund managers are estimated to have accounted for less than 30 percent of all transactions on the German SII market. The reason for this is not only the increase in the number of intermediaries and investors but also the increasing investment activity of the two social venture capital fund managers outside of Germany (primarily in Austria and the UK).
In 2015, the annual transaction volume amounted to between 4 and 5 million euro.

Our estimates put the transaction volume for 2015 between 4 and 5 million euro. The fall in transaction volume following the termination of the KfW-co-financing programme in December 2014 is expected to have been compensated by other investors. A further encouraging development is the steady increase in average transaction values to more than 300,000 euro per transaction since 2012. This increase is driven primarily by experienced intermediaries, while new investors and intermediaries usually invested amounts of up to 200,000 euro. On the basis of the anticipated increase in investable impact assets to around 70 million euro with additional planned launches of new funds, annual investments of 7 to 8 million euro are forecasted for 2016.

The programme for the co-financing of social enterprises was launched in May 2012 at the initiative of the Federal Ministry for Families, Senior Citizens, Women and Young People (BMFSFJ) with the aim of promoting the growth of social enterprises in Germany. Under this programme, the Kreditanstalt für Wiederaufbau (KfW), along with a lead investor, invested up to 50 percent under equal conditions (pari passu) through equity capital or mezzanine capital.

Until the programme’s termination in December 2014, around 1.5 million euro (commitment volume until 31.12.2014) was invested in 11 different social enterprises. Before the programme ended, KfW was the largest investor (by number of transactions) on the German SII market. In addition to co-investments with BonVenture and Ananda Ventures, KfW invested with various lead investors, such as Social Business Angels, a foundation, a state-owned investment fund for SMEs and a charitable welfare association.

Overall, the programme did not meet expectations due to a disappointing development of transactions with the number of applications in 2014 even lower than in the previous year. The programme, which was very resource-intensive was therefore terminated at the end of 2014 due to cost considerations.

The beginning of 2015 saw the launch of the ERP Venture Capital Fund Investments programme. The scope of this programme enables KfW, in principle, to invest in social venture capital funds. Social enterprises only indirectly benefit from this new programme. So far, however, KfW has not invested in a social venture capital fund under the new programme.
Employment and education were the most prominent target sectors for impact investments in Germany in the past three years.

In terms of the number of transactions, most impact investments from 2013 to 2015 were made in employment (20 percent) and education (18 percent), followed by health (12 percent) and sustainable consumption/environment (9 percent) (Fig. 6). This distribution reflects the primary investment interests of the largest intermediaries and investors on the market. Ageing society, inclusion, equality, regional development and the promotion of social entrepreneurship are further sectors in which impact investments were made during the period under review.

Between 2013 and 2015, 80 percent of investments were placed in impact-driven for-profit social enterprises, whereas only 20 percent of the financed organisations were charitable (Fig. 7). This investment focus results from two main factors: the type of capital available (early-stage growth financing) as well as the restrictions imposed by Germany charity law (such as the prohibition of dividend payouts to investors).
Mezzanine financing and debt capital are the primary forms of financing utilised in the German SII market.

Our survey suggests that the most common types of financial instruments used in SII between 2013 and 2015 are mezzanine capital and unsecured debt capital. However, anecdotal evidence indicates that the proportion of equity deals has increased over the past three years. The incomplete details given by the survey respondents do not, however, permit any quantitative evaluation by type of financing. In the past two years, the Financing Agency for Social Entrepreneurship (FASe) also piloted hybrid financing models in which mezzanine capital was combined with donations.

Owing to the confidentiality concerns of the intermediaries, it has not yet been possible to assess the actual returns from investments or investment products placed on the German market. Published return expectations however, are in the low single-digits (no more than 5 percent) and thus far from being adequate, risk-adjusted market rates of return. Anonymised regular publication of actual returns help to collect reference points which may contribute towards lower due diligence costs for future transactions. In the UK, the EngagedX index has been introduced, through which the leading intermediaries regularly submit their transaction data to an independent organisation.
Overall, the market has remained largely stable over the past three years in terms of number of transactions, despite the termination of the KfW programme. In 2015, the investment volume lay between 4 and 5 million euro. In terms of structure, the German SII market is still strongly influenced by the activities of the two large social venture capital fund managers, which is reflected both in the investment focus and in the type of financing employed. Owing to the anticipated increase in investable assets to around 70 million euro with further fund launches of around 15 million euro\(^\text{15}\) planned for 2016, we expect annual investments of between 7 and 8 million euro. This estimate is based on market participants and investment products which we have included in the survey. Furthermore, it is likely that new investment products and/or new intermediaries will make additional investments that we have not included in the survey and the value of which cannot currently be determined.

Despite future growth opportunities still being concentrated in the hands of a small circle of actors, the development of a market infrastructure has progressed compared to 2012. This is clearly evident in the number of newly founded organisations set up in the past three years, as shown in Fig. 3. The question of how the market environment has actually developed and what obstacles are hindering growth will be examined in detail in the next chapter.

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\(^{15}\) Includes the second closing of the BonVenture III fund (expected to be 20 to 25m euro) as well as the FASE Early-Stage Co-Investment Fund (expected to be around 5.5m euro).
V. DEVELOPMENT OF THE INDIVIDUAL MARKET SEGMENTS

Our research findings and the qualitative interviews with market experts, investors and intermediaries show that the German SII market is still in an early experimental phase. Although individual market actors are demonstrating the viability of social impact investing in niches, there is still no functioning infrastructure connecting supply and demand. It is necessary to adopt targeted measures in order to develop and enlarge the market to a critical size. To this end, the German National Advisory Board published a number of recommendations in its final report in September 2014. The following section analyses the development on the investor, intermediary and investee sides of the market, as well as the market environment since 2012, and evaluates the extent to which the NAB-recommendations have been implemented.

5.1. Investors: What does the investor landscape look like?

The composition of investors on the German SII market has changed little over the past three years.

As can be expected in this early stage of the market, the most important investors are still wealthy individuals/business angels and foundations. During the period of the KfW co-financing programme, the state was also an important investor, but it withdrew completely from the market at the end of 2014. Future market growth will strongly depend on the extent to which new groups of investors can be reached or the interest in SII among existing groups of investors can be stimulated. All in all, the increase in investable impact assets demonstrates that it has been possible to gain new investors in the past three years.
Wealthy individuals still constitute the most active investor group on the German SII market.

From the early stages of the market, wealthy individuals (known as High Net Worth Individuals, HNWI)\(^{16}\) with an entrepreneurial background played a pioneering role as social impact investors in Germany. As the final report by the German NAB explains, many of the investments made so far have been socially motivated and were not primarily intended to achieve financial returns.\(^{17}\) In addition, these individuals often function as business angels, promoting the growth and development of the organisations they have invested in. This group has grown since 2012. Private investors have also increasingly benefited from simplified access to investment opportunities due to the advisory service provided by the FASE and membership of investor networks (e.g. Toniic, Ashoka Support Network).

Despite their importance for the market, the group of wealthy private investors remains relatively small. According to a study conducted by the University of Stuttgart on behalf of Bertelsmann Stiftung,\(^{18}\) only a limited number of wealthy individuals in Germany have so far given any consideration to the subject of social impact investing. If they do invest, social impact investing constitutes only a modest proportion (up to 3 percent) of their investments, which tend to be regarded as separate from the overall portfolio of assets and merely supplement their philanthropic activities. According to this study, family offices, which often advise private investors, are generally sceptical towards the subject of social impact investing. The lack of advice, as well

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\(^{16}\) Wealthy individuals with investable assets of more than 1 million US dollars.
\(^{17}\) National Advisory Board (2014), p. 42.
as the insufficient availability of investment products and a functioning market infrastructure are the biggest obstacles for private investors.

In order for the German SII market to grow in future, wealthy individuals will remain a key investor group which will need to be cultivated. Through their active role as investors (business angels) and the flexibility of being able to accept below-market returns in order to demonstrate the viability of SII, they offer substantial potential for the German SII market. In the short to medium term, however, further groups of investors will need to be drawn in.

Since 2012, foundations have continuously expanded their role as social impact investors.

So far, foundations in Germany have not assumed the same pioneering role for the SII market that they have in Anglo-Saxon countries. The foundations themselves regard regulatory uncertainties as the largest barrier to entry, as German foundation law is regulated at the state rather than federal level. Furthermore, as of yet there are very few investment products which correspond to the risk/return/liquidity profile that is relevant to foundations.

Despite these obstacles, over the past three years there has been great interest on the part of foundations in investing their assets with a focus on impact arguably influenced by, among other things, currently prevailing low interest rates. On the basis of the report entitled "Mission Investing in the German Foundation Sector", fifteen pioneering foundations came together in 2013 to establish an expert group on impact investing. The aim of this group is to verify the legal framework conditions and identify and develop instruments to enable foundations to engage in social impact investing. The publication of a guidebook for foundations, providing practical advice on the implementation of SII, is planned for 2016. Also, in 2015 the MRI Pilot Fund for Education was initiated by this expert group.

The MRI Pilot Fund for Education is the first social impact investment product specifically for foundations that was launched at the beginning of 2015 by the expert group on impact investing of the Association of German Foundations. Six foundations (Bertelsmann Stiftung, BMW Foundation Herbert Quandt, Castrignius Kinder- und Jugend-Stiftung, Eberhard von Kuenheim Stiftung der BMW AG, Hoffnungsträger Stiftung and Schweißfurth Stiftung), as well as the Association of German Foundations, have each invested 100,000 euro in the fund. The total volume of 700,000 euro is to be invested in organisations and projects active in education in German-speaking countries. The Pilot Fund is set to run for 4 to 6 years with an anticipated return of two percent after costs. The social venture capital fund BonVenture (EUSEF-certified) administers the Pilot Fund. In 2016 the fund is expected to complete three investments in social enterprises in the education sector.

A further positive development is that three foundations from among the expert group (Eberhard von Kuenheim Stiftung der BMW AG, BMW Foundation Herbert Quandt and Bertelsmann Stiftung) have allocated part of their foundation assets (totalling 10 million euro) for social impact investing. There is also ongoing discussions among the expert group about binding capital commitments by all members for impact investing.

Owing to the risks and costs associated with social impact investments, however, currently only financially strong foundations, with assets of more than 1 million euro, are considered likely to be in a position to engage in social impact investing. Hence, despite the momentum that this investor group has created over the past three years and its important role in guiding the development of the market, its long-term potential as investors is probably limited.

The German state has largely withdrawn as an investor. German funds benefit from capital injection from the European Investment Fund.

Considering the investor mix, it is particularly striking that the German state has hardly become involved as a social impact investor. Since the termination of the KfW co-financing programme (Infobox 2), the German federal government has only invested in emerging and developing countries. In theory, social venture capital funds can also receive injections of capital from the ERP Venture Capital Fund Investment programme, but so far no German fund has benefited from this programme.

The German SII market is therefore currently only benefiting from state investment programmes at the European level, such as the co-investment program for social venture capital funds (Social Impact Accelerator) of the European Investment Fund (EIF, Infobox 1). According to our information, the EIF has...
already invested more than 10 million euro in German funds and is negotiating further investments for 2016. Hence, the EIF constitutes an important pillar of stability for the German SII market.

**Institutional investors still play a subordinate role due to the lack of suitable investment products.**

Around the world, institutional investors (including banks, investment funds, pension funds and insurance companies) have the most capital available for investment, and in the long term the involvement of this investor group will show whether the SII market is able to develop from a niche to the mainstream of the global investment market. Although our investigations have revealed an increase in investments by institutional investors compared to 2012, the increase was very small. Here, too, only a few individual institutes are active and they do not regard investments in the SII market as strategic portfolio investments. Institutional investors are subject to strict statutory regulations regarding the investment of their assets. On account of the small size of the transactions, the illiquid forms of investment and the low prospect of competitive returns, the level of interest in SII products among institutional investors in Germany has so far been limited. According to the final report of the National Advisory Board, real estate may, in the medium term, be a form of investment that is of interest to institutional investors. In Germany, however, there are still no suitable investment products in this area with any measurable social impact.

**Other investor groups are not yet active on the SII market.**

There is an observable general interest in the subject of social impact investing on the part of German enterprises which has increased over the past three years. Whereas companies often actively promote the establishment and growth of social enterprises via corporate social responsibility departments (e.g. SAP) or foundations (e.g. Vodafone Foundation), they have rarely taken on the role of social impact investors. One exception is Tengelmann Social Ventures, the social venture capital arm of the Tengelmann Group, which has been active on the market since 2013 and has so far invested in three impact-driven organisations.

Owing to their ability to become involved on a regional level and to directly observe the effects of the investments, small-scale investors are, in principle, open-minded towards SII and are already investing in standardised, purpose-driven investment products (e.g. climate protection savings certificates, organic farming funds), which are offered by alternative and ethical banks. On account of the high minimum investment amounts for SII funds it is, however, difficult for small investors to invest in SII products in Germany. Since 2013 small investors have theoretically been able to invest directly in social start-ups via the Social Impact Finance programme on the Startnext crowdfunding platform (crowdinvesting in the form of cooperative shares or subordinated loans). On the basis of the Protection of Small Investors Act passed by the Bundestag, which came
into force in July 2015, no crowdinvesting projects are being accepted by this platform for the foreseeable future. Thus, small investors are limited to a modest number of small-scale regional organisations (e.g. Regionalwert AG).

Thanks to the initiative of some German foundations, progress is evident in attracting this investor group which is so important for the development of the market. Gaining more wealthy individuals and the state as investors is key in this phase of market development.

With the establishment of the expert group on impact investing, the planned publication of their guidebook and the launching of an impact-driven investment product for foundations, a number of NAB-recommendations have already been fulfilled. We are confident that further innovative impulses are to be expected from this expert group in the future. The development of other investor groups (except the public sector) depends heavily on the availability of suitable investment opportunities for these groups. Progress in this regard will probably only be achieved over the medium or long term. Although there is a generally positive attitude towards SII, investors frequently do not know how they can invest their capital in an impact-driven way. A positive step towards countering this issue is that the availability of information regarding the needs of investors and potential investment opportunities has improved as a result of various studies published in the recent past. A key factor in the further development of the German SII market will be attracting foundations, wealthy individuals and the state as investors. With their knowledge and their capital, these investor groups could push forward the strategic development of the SII market with a social mission. Since they do not act purely out of financial interest, they also have the flexibility to provide risk capital during this experimental phase.
Fig. 9: Progress in implementing the NAB-recommendations with regard to capital supply

<table>
<thead>
<tr>
<th>AREA OF ACTIVITY</th>
<th>Measure</th>
<th>Progress</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Perception and transparency of SII</td>
<td>Increasing available information on SII with reports and the creation of an investment platform</td>
<td>Moderate progress</td>
<td>Various reports on the needs of investors and investment opportunities as well as market reports have been published</td>
</tr>
<tr>
<td>Involvement of foundations in SII</td>
<td>Foundations voluntarily commit assets to SII</td>
<td>Moderate progress</td>
<td>Three foundations from the expert group on impact investing have allocated assets to SII</td>
</tr>
<tr>
<td></td>
<td>Incentives for foundations to engage in impact reporting</td>
<td>No change</td>
<td>Impact investing guidebook by the Association of German Foundations to be published in 2016</td>
</tr>
<tr>
<td></td>
<td>Creation of legal certainty for foundations</td>
<td>Moderate progress</td>
<td></td>
</tr>
<tr>
<td>Increasing the participation of retail investors</td>
<td>Development of new impact-driven financial products for retail investors, particularly crowdfunding</td>
<td>No change</td>
<td></td>
</tr>
<tr>
<td>Relaxing regulatory restrictions for institutional investors</td>
<td>Development of new investment vehicles (e.g. Social Impact Bonds) and exit options</td>
<td>No change</td>
<td></td>
</tr>
</tbody>
</table>

Source: own illustration.

5.2. Intermediaries and products: Which channels does capital flow through?

Organisations which offer social impact investment products, such as mutual funds, are known as intermediaries. Intermediaries mediate between investors and investees by collecting money from investors and then providing it to impact-driven organisations to finance their activities. Thus, they focus the supply of capital and transfer it efficiently into the very fragmented market of investees. At this early stage of the market, the intermediaries also support investees with know-how and advice, and guide investors towards social impact investing as a segment of the capital market. They therefore play a key role on the German SII market. In Germany around two thirds of the annual amount invested in SII flow via intermediaries. However, there are only a handful of intermediaries active on the German SII market and only a few investment managers have the experience or ‘track record’ that is so important for investors.
Fig. 10: Overview of the intermediaries on the German SII market

<table>
<thead>
<tr>
<th>INTERMEDIARY</th>
<th>Products/Funds</th>
<th>Type of financing</th>
</tr>
</thead>
<tbody>
<tr>
<td>ANANDA</td>
<td>SVF I (2010) – 7.3m euro</td>
<td>Equity, mezzanine capital, debt capital</td>
</tr>
<tr>
<td></td>
<td>SVF II (2013) – 22.3m euro</td>
<td></td>
</tr>
<tr>
<td>BONVENTURE</td>
<td>BVI (2004) – 5m euro</td>
<td>Equity, mezzanine capital, debt capital</td>
</tr>
<tr>
<td></td>
<td>BVII (2009) – 10m euro</td>
<td></td>
</tr>
<tr>
<td></td>
<td>BVIII (2015) – currently undergoing Fundraising, 13.2m euro (first closing)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>MRI Pilot Fund (2015) – 0.7m euro</td>
<td></td>
</tr>
<tr>
<td>JUVAT</td>
<td>Eleven Augsburg (2013) – n/a</td>
<td>Social Impact Bond</td>
</tr>
<tr>
<td></td>
<td>No fund of its own, investments from Tengelmann Venture Capital Fund</td>
<td>Equity, mezzanine capital</td>
</tr>
</tbody>
</table>

The intermediary landscape is dominated by the activities of the two large social venture capital fund managers.

According to our survey, the German SII market is still strongly influenced by the two major social venture capital fund managers BonVenture and Ananda Ventures, which at the end of 2015 were managing a total of nearly 60 million euro and have invested in more than 35 social organisations since they were established. These fund managers are the largest impact investors in Germany and therefore shape the predominant type of financing and the investment focus. Compared to 2012, the market share (in terms of the number of transactions) of these two fund managers has decreased due to a large number of new investors in the market. Nevertheless, owing to the higher average investment per transaction, these two actors still invest the largest amount of capital overall. Over the past three years, these two investment companies have increasingly invested outside Germany (primarily in Austria and the UK), in keeping with the investment focus of their funds.
Social and ethical banks are not yet active as intermediaries on the German SII market, but they do offer a broad range of purpose-driven investments.

Social and ethical banks in Germany, such as EthikBank eG, the GLS Gemeinschaftsbank eG, Triodos Bank, UmweltBank and the Bank für Sozialwirtschaft AG, which is run by welfare associations, primarily finance organisations and projects with social or environmental impact, such as schools, hospitals, renewable energy projects and organic agriculture. Since these investments do not yet involve any impact measurement and reporting, they are categorised as purpose-driven investments according to our market definition. Impact measurement and reporting entails considerable adjustment of normal banking procedures and therefore also gives rise to increased costs for the banks. According to a recent study, banks are therefore only slowly turning their attention to social impact investment. However, there is a clear interest on the part of the banks, particularly because private investors and foundations are often seeking investment products which can achieve local impact. In response to growing demand, the social and ethical banks are also increasingly considering measuring the impact of their existing investment products and/or launching specific SII products for the German market. Pioneers of this movement are member banks of the Global Alliance for Banking on Values, such as GLS Gemeinschaftsbank eG and Triodos Bank. For example, since January 2014, Triodos Bank has been offering an SII fund in the field of organic agriculture for Dutch customers. GLS Gemeinschaftsbank eG has developed a financing partnership for social entrepreneurs (see Infobox 5), which is to be launched in 2016. On the basis of their long-standing experience in the financing of social organisations and projects, as well as their knowledge of the target sectors, social and ethical banks could, in the medium term, play an important role as intermediaries on the German SII market, as is the case in the UK, where the social banks are the largest intermediaries on the SII market. A recently released analysis by McKinsey & Company estimates that adding impact measurement to the existing portfolios of the four largest social and ethical banks would yield a potential of nine billion euro to the social impact investment market.

Through its financing partnership for social entrepreneurs (Finanzierungspartnerschaft für Sozialunternehmer), GLS Gemeinschaftsbank eG offers a platform which provides social enterprises with growth capital (mezzanine capital). With regard to the remuneration structure, social impact is also to be considered. In offering this product, GLS Gemeinschaftsbank eG cooperates with organisations such as the Financing Agency for Social Entrepreneurship as well as interested social impact investors and foundations. Impact measurement and reporting is not conducted by the bank, but by the social enterprise itself. This platform is expected to be launched in early 2016.

There is a limited number of available SII products, which, in addition, only cover part of the risk-return spectrum.

The number of active intermediaries and available products hardly changed between 2012 and 2015. The mezzanine or debt financing of social enterprises in the growth phase is still predominant in the German SII market, hence only a limited part of the risk-return spectrum is covered. Other asset classes such as real estate are only slowly becoming available. Owing to the small number of products and investment opportunities, it is hardly possible for investors to invest large amounts.

As a product innovation on the German SII market, the first German Social Impact Bond was piloted in Augsburg in December 2013. So far, however, no further Social Impact Bond pilot projects have been implemented. In contrast to the Anglo-Saxon countries, where the creation of Social Impact Bonds is actively supported by government, Germany faces difficulties in conveying the value proposition of this new financing instrument to the public sector. Additionally, the involvement of private investors in the provision of public services gives rise to reservations. Nevertheless, the interest of the public sector and of social organisations in this new financing instrument has tangibly increased over the past few years. A positive development is that the Federal Employment Agency (BA) is evaluating if the piloting of SIBs for the sustainable integration of long-term unemployed people into the primary labour market can be supported at the job centre level. Long periods of negotiation and development, owing to the involvement of the public sector and German social welfare legislation, have delayed the creation of new Social Impact Bonds. Without active state support for impact-oriented financing models, for example through the form of Outcomes Funds (see section 4.3.), the development and implementation of Social Impact Bonds in Germany is proving to be time-consuming and costly.
Social Impact Bonds are contracts between the public and private sectors which aim to provide effective solutions and implement preventive measures to deal with intractable social problems. With a Social Impact Bond, private investors pre-finance the provision of services by an innovative social service provider. When the measured outcomes have been confirmed by an independent evaluator, payment is made to the impact investors from the public purse — based on the impact that has been achieved. The advantage for the public sector is that the increased effectiveness of a social service results in lower costs in the future. At the same time, the generally higher costs for undertaking preventive measures and the risk of implementing an innovative programme are outsourced to social investors. Social Impact Bonds are particularly useful in the case of difficult social problems where state measures have brought little success, such as youth unemployment, certain areas of adolescent welfare services, juvenile detention and the integration of refugees.

The first German Social Impact Bond pilot project was launched in September 2013 under the name Eleven Augsburg, aiming to bring at least 20 hard-to-reach, disadvantaged young people in the Augsburg region into employment and vocational training.

The basis for Eleven Augsburg is an agreement between Juvat gGmbH, a subsidiary of the Benckiser Stiftung Zukunft and the Bavarian State Ministry for Employment and Social Welfare, Families and Integration. Advance financing for the project is provided by BMW Foundation Herbert Quandt, the BHF-Bank Foundation, BonVenture gGmbH and the Eberhard von Kuenheim Stiftung der BMW AG. Four social service providers are involved in the project. Following completion of the pilot phase and the evaluation of the outcomes, the results of the project are expected to be published in February 2016. In addition to the Eleven Augsburg project, the Benckiser Stiftung Zukunft also initiated another Social Impact Bond pilot project in September 2015, this time in collaboration with the Austrian Federal Ministry for Employment, Social Welfare and Consumer Protection, with the aim of improving the economic and social situation of women threatened by violence.

In addition to the Benckiser Stiftung Zukunft, the Bertelsmann Stiftung is also promoting the development of Social Impact Bond pilot projects in Germany, primarily with a focus on youth unemployment and youth welfare services. Around 4 to 6 projects, mainly in youth unemployment, are currently being developed.
The launching of new products by existing intermediaries is gradually broadening the range of available investment products.

In addition to the development of Social Impact Bonds through philanthropic capital, existing SII actors are actively working on the broadening of the financing spectrum. For example, BonVenture supported the impact investing expert group on the launching of the MRI Pilot Fund. The management of Ananda Ventures co-initiated an impact-driven project for the development of affordable housing (Infobox 7). As part of its mediating services, the Financing Agency for Social Entrepreneurship—which, strictly speaking, is not an intermediary but an advisory service provider—is seeking to standardise new forms of financing such as participation rights capital or revenue-sharing models in order to increase the replicability of the individual types of transactions. In order to fill the financing gap in early-stage social enterprises requiring less than 500,000 euro, it also intends to launch an Early-Stage Co-Investment Fund (Infobox 6). A consortium consisting of Phineo gAG, the Bertelsmann Stiftung and Ananda Ventures GmbH, which is being co-funded by the EU, also recently evaluated the viability of a SocialTech start-up fund for impact-driven business start-ups in the technology sector.

Even though the existing actors are displaying increased activity, the burden of innovation still rests on few shoulders. The lack of financing and impact expertise remains a bottleneck for the growth of the German SII market.

**INFOBOX 6**

**The Early-Stage Co-Investment Fund**

The Early-Stage Co-Investment Fund was initiated in 2015 by the Financing Agency for Social Entrepreneurship. The aim of this fund is to create a capital pipeline for early-stage social ventures that are currently unable to find sufficient financial resources. This is supposed to create a basis for the later involvement of social impact investors (e.g. larger social venture capital funds). Alongside one or more lead investors, the Co-Investment Fund invests under the same conditions (up to a maximum of 50 percent of the total investment amount) in social ventures that have been identified by the FASE. The planned volume of the fund is 5.5 million euro and investments are to be placed in approximately 30 social ventures over a period of five years. Potential investment candidates will be identified in the context of FASE’s advisory services. By means of partial risk mitigation through EU guarantees, the fund should enable its investors to gain a small positive return after costs. Investors in this fund are wealthy individuals and foundations, family offices and other institutional investors. The first closing of the fund is planned for the beginning of 2016.
The company WohnRaumGesellschaft, which was founded at the end of 2015, is an impact-driven project developer co-initiated by Ananda Ventures GmbH, dedicated to the creation of high-quality affordable housing for people on middle incomes in German cities. Average earners such as nursery school teachers, geriatric nurses, police officers, office employees, craftsmen and small business owners, who form the backbone of urban society and are the prime movers of the urban economy can no longer afford the rising rents and are increasingly being driven out of city centres — with negative consequences for the people themselves, the cities and urban life in general. As a private project developer, the company is seeking to counteract this in a purposeful way by developing residential, living and working quarters in city centres.

WohnRaumGesellschaft is backed by investors who, above all, aim to achieve the greatest possible social impact through their involvement, as well as gaining financial returns. The projects run by WohnRaumGesellschaft are the first social impact investment products in the real estate sector in Germany.

**INFOBOX 7**

WohnRaumGesellschaft

The range of intermediaries and products has changed little over the past three years, but increased market activity from 2016 onwards sheds a positive light on the implementation of the NAB-recommendations.

Intermediaries play a key role in the young German SII market, since they can channel the capital flows from investors and direct them into the fragmented and sometimes still undeveloped SII market. The German SII market is characterised by a small number of intermediaries with investment experience and few standardised products which cover only a small part of the risk-return spectrum. Whereas both of the two large social venture capital fund managers have launched additional funds over the past few years, they are also increasingly seeking to use their expertise for the development of new products. In addition, the Financing Agency for Social Entrepreneurship and GLS Gemeinschaftsbank eG have appeared as new driving forces for SII products. Although Social Impact Bonds are products that are difficult to implement, two foundations are financing their piloting in Germany. With regard to the implementation of the NAB-recommendations, the outlook is generally positive, even though progress has not been made in all areas. On the basis of increased market activity, future market growth is expected, owing to the enlargement and diversification of the range of products and intermediaries.
5.3. Investees: How has the investee side developed?

Impact-driven organisations as investees in the SII ecosystem can have various legal forms.

On the demand side of the SII market, there are impact-driven organisations whose core of business activity it is to achieve an effective social impact. Social impact is thus at the focus of these organisations and is not merely a by-product of their main business activity. These organisations are sometimes also referred to as social enterprises. This is reflected in the definition of the Social Business Initiative of the European Commission: "The objective of social businesses is not the maximisation of profit but the common good (ecological, social or societal objectives). Through their products and services, as well as through their organisational or production methods, they often have an innovative character. Furthermore, they frequently employ socially disadvantaged individuals (people affected by social exclusion). They therefore make a contribution towards social integration, employment and reducing inequality." 31
As Fig. 13 shows, impact-driven organisations can be both for-profit social enterprises and charitable organisations. Owing to the limitations set out in German charity law (e.g. the prohibition on dividend payments to investors, the requirement that financial resources be used promptly and the prohibition of losses) and the resulting financing difficulties faced by early-stage, growing organisations, many impact-driven organisations set up a costly hybrid structure. In order to remove the necessity for this circuitous route, experts recommend that a new legal form should be considered for impact-driven organisations, allowing them to pursue both their social purpose and economic objectives.

**Fig. 13: Overview of impact-driven organisations in Germany**

<table>
<thead>
<tr>
<th>IMPACT-DRIVEN ORGANISATIONS</th>
<th>Purely commercial enterprises</th>
<th>Sustainable enterprises</th>
<th>For-profit blended value social enterprises</th>
<th>Mission locked social businesses</th>
<th>Social benefit enterprises</th>
<th>Charitable Organisations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary mission</td>
<td>Profit maximisation</td>
<td>(Socially responsible) generation of profits</td>
<td>Generation of profits whilst maximising social impact</td>
<td>Maximisation of social impact with profit as a byproduct</td>
<td>Maximisation of social impact</td>
<td>Social mission</td>
</tr>
<tr>
<td>*Legal form (examples)</td>
<td>*UG, GmbH, AG</td>
<td>*UG, GmbH, AG</td>
<td>**gUG, gGmbH, gAG</td>
<td>**gUG, gGmbH, gAG</td>
<td>**gUG, gGmbH, gAG</td>
<td>**gUG, gGmbH, gAG</td>
</tr>
<tr>
<td>Financial sustainability</td>
<td>Profitable</td>
<td>Profitable</td>
<td>Profitable</td>
<td>100% of costs covered by turnover/profitable</td>
<td>50%-75% of costs covered by turnover</td>
<td>Little to no turnover, donation-dependent</td>
</tr>
<tr>
<td>Distribution of profits</td>
<td>Possible</td>
<td>Possible</td>
<td>Possible (within reasonable limits)</td>
<td>Usually not possible</td>
<td>Not possible</td>
<td>Not possible</td>
</tr>
<tr>
<td>Social mission lock applicable?</td>
<td>No social mission lock</td>
<td>No social mission lock</td>
<td>Usually no social mission lock</td>
<td>Social mission lock applies</td>
<td>Social mission lock applies</td>
<td>Social mission lock applies</td>
</tr>
</tbody>
</table>

*corresponds to unlimited company, Ltd, Plc
**the lower case “g” denotes gemeinnützig, i.e. non-profit
SII intermediaries focus on the financing of early-stage impact-driven organisations in the growth phase.

The social sector in Germany is dominated by six large welfare associations. By comparison, young social enterprises in the growth phase are a niche phenomenon. Owing to the lack of data, there have been only a few estimates concerning the addressable market for social impact investing in Germany thus far. According to a study by the Centre for Social Investment (CSI) at Heidelberg University, in 2013 there were approximately 1,000 to 1,500 ‘highly innovative social enterprises’ in Germany, which more or less corresponded to the above definition of impact-driven organisations. Experts such as the Social Entrepreneurship Akademie in Munich assume that there is a considerable number of unrecorded social impact organisations which, in effect, provide a social service but which do not self-identify as social enterprises. Most of these social enterprises are small and active at the local level. Only around 30 percent of these organisations generate revenues in excess of 1 million euro. Young, innovative organisations are very much the focal point of interest for social impact investors because they frequently need growth financing and find it difficult to obtain funding from traditional sources of finance (e.g. bank loans). However, the investee side is not limited to social start-ups; established organisations which have a social impact (e.g. member organisations of the welfare associations) can also receive SII capital. These, however, require new forms of financing (e.g. real estate financing) and greater volumes than are currently available on the German market. In addition, they do not have problems obtaining financial resources on traditional capital markets and rarely measure the social impact of their activities. A recent McKinsey & Company analysis suggests that there are up to 4,000 young impact-driven organisations in Germany in addition to the 70,000 established organisations who could theoretically be financed through SII in a developed market.

In early-stage financing there is a financing gap for young impact-driven organisations.

Since 2012 around 50 new impact-driven organisations have been (co-)financed through SII. Often, an initial SII investment leads to further rounds of financing. On account of the financing limitations for charitable organisations, the majority of organisations in which investments flow are for-profit. According to the results of our survey, investable business models frequently exist in the spheres of employment, education and health. The intermediaries still find it difficult to find investable impact-driven organisations; the social venture capital fund managers, for example, have to evaluate a large number of organisations before they can make an investment. Compared to 2012, the activity of the incubators (above all, the Social Impact Labs) has greatly increased, but it will take time before the start-ups are able to take on the growth financing that is currently

32 Arbeiterwohlfahrt, Caritas, Diakonie, Paritätischer Wohlfahrtsverband, Rotes Kreuz, Zentralwohlfahrtsstelle der Juden in Deutschland
33 Scheuerle et al. (2013), p. 50.
37 Evaluation of the survey.
being offered by the intermediaries. There is a financing gap for social impact organisations with an investment volume of less than 300,000 euro, so that many do not even reach the stage of growth financing. For example, the Social Impact Lab, which now has eight branches, has been guiding around 240 start-ups since 2012, only two of which have been financed by the intermediaries named in this study. In order to overcome the financing gap for early-stage ventures, the Financing Agency for Social Entrepreneurship has developed an Early-Stage Co-investment Fund (Infobox 6). A consortium consisting of Phineo gAG, Bertelsmann Stiftung and Ananda Ventures, which is being co-funded by the EU, also recently evaluated the viability of a SocialTech start-up fund for impact-driven start-ups in the technology sector.

Over the past few years advisory and support services for social enterprises have gradually been expanded, but much remains to be done.

The supply of advisory and support services available to social enterprises has been expanded in recent years, particularly with regard to promoting start-ups and incubation units (Social Impact Lab, Impact HUB, Social Entrepreneurship Akademie), which provide guidance for social impact organisations at a very early stage, sometimes at a stage when they are not yet fundable. Owing to the continuous strengthening of this area, larger organisations will be ready for the deal pipeline of the SII intermediaries in the medium term. In order to further catalyse this area, there is discussion of other measures in addition to the launching of the aforementioned early-stage fund, such as the transfer of various models of traditional high-tech start-up support to the SII sphere. These include innovation clusters, the adoption of consultancy methods and the standardisation of advisory services.

Overall, the development of the investee side of the SII ecosystem remains dependent on philanthropic or state funding, since the investees themselves are not in a position to pay for consultancy or support services.

So far, few of the recommendations relating to the investee side have been implemented.

There is still a lack of information regarding the size of the market and the needs of the investees. Although the supply of advice and support for social impact organisations has been improved, even to the level of investment-readiness, experts demand further measures in this area. As part of a study by the Federal Ministry for Economic Affairs and Energy, the potential application of existing start-up and financing programmes (for for-profit enterprises) to impact-driven organisations is currently being investigated. There is also talk of introducing a new legal form for social impact organisations in order to make complex and expensive hybrid organisational structures unnecessary.
5.4. The market environment: What is the state of current support structures?

The number of organisations which advise market participants or support market development has increased over the past three years.

The market environment encompasses a broad range of different organisations which contribute to the market infrastructure. In various functions, they provide advice either to investors or investees during the investment process (advisers) or they support the development of the market as such (supporters). Particularly in the development of young markets, where investors and investees are still inexperienced, they therefore play a key role. As Fig. 3 (page 16) shows, the number of advisory organisations, in particular, has increased since 2012. New organisations have been founded particularly in the areas of product development and the provision of advice to investors, sectors that displayed a dearth of activity in 2012.
Despite the progress achieved so far, more targeted investments in the development of the market infrastructure are required.

Over the past three years, estimates suggest a high single-digit million amount of private/philanthropic capital has been invested in market development efforts. Most of the funding benefited advisers on the investor and investee sides. Philanthropic organisations such as Ashoka gGmbH, Bertelsmann Stiftung and BMW Foundation Herbert Quandt, as well as private donors financed this market building process. While it is true that numerous advisory organisations are now active, they are often very small and not in a position to finance themselves by means of their services on the market. Consequently, this supportive involvement will likely continue over the next few years. At the same time, it can also be observed that these advisory and supporting organisations are able to increasingly finance themselves – whether through consultancy fees or through state or EU funding. Progress has already been achieved by the market actors with regard to the implementation of the NAB-recommendations, even though the financing and support of the market infrastructure still remains an important task in the development of a more mature German SII market.
Detailed analysis of the individual market segments (supply, intermediaries and products, demand, market environment) demonstrates that the young German SII market still has to contend with major structural deficiencies: a narrow investor base, small and insufficiently diversified intermediaries, a limited number of investment products, few investable impact-driven organisations and continued need for support in the building of a functioning market environment. Nevertheless, it has been clearly shown that the German SII market has developed in qualitative terms, and has become more robust. For example, existing funds have been able to collect more capital from investors, some foundations have become active social impact investors, existing intermediaries are developing new investment products, more impact organisations are being financed through social impact investing and the supporting market environment of advisers and supporters has stabilised. A particularly positive development is that initial progress in implementing the recommendations of the German NAB has been made through engaging foundations as investors, the development of new investment products and the building of the market environment. Since the NAB does not have any political authority and is not linked to policy-making institutions, however, the further implementation of the recommendations is the responsibility of the individual market actors.

**Summary:** Over the past three years the German SII market has continued to develop in all market segments, although it still has to contend with major structural deficiencies. Particularly in the areas of attracting foundations as investors, the development of new investment products and the building of the market environment, recommendations of the National Advisory Board have already been implemented.
VI. PROSPECTS FOR THE GERMAN SII MARKET: THE UK EXAMPLE

The development of the UK SII market can, in many respects, serve as an example of how the initial difficulties facing young SII markets can be tackled through systematic and coordinated market building efforts.

As argued above, the German SII market is currently in an experimental phase. However, the challenges arising from this are certainly not specific to Germany but follow a pattern that can be observed in other young SII markets, as the work of the Social Impact Investment Taskforce has demonstrated. The creation of SII markets is like the chicken-and-egg problem: on the demand side, it is difficult for impact-driven organisations to get financing or to obtain public-sector contracts. Consequently, there is a relatively small number of impact-driven organisations, which when translated to the investor side means that there are few investable opportunities. From the perspective of policymakers, the current market seems very small and not fully defined, so that it is not worthwhile launching expensive initiatives. On all sides of the market, there are understandable reasons for a wait-and-see attitude. In order to overcome this attitude, a coherent strategy is required. This section will look at the example of the UK to show how the initial difficulties that are evident on the German market can be overcome. The case study will go beyond the very specific recommendations of the German NAB that were analysed in the previous section, by illustrating how the market as a whole can be developed through systematic coordination. In the UK this coordination was initiated by a task force of experienced practitioners set up in 2000 at the initiative of HM Treasury. For more than a decade, this task force advised the government concerning the development of the SII market. As a result of the initiatives arising from that, the SII market in the UK grew to 202 million British pounds by 2012.38

The focus of market development was on the creation of robust, diversified intermediaries which efficiently mediate between supply and demand and demonstrate the viability of SII.

The majority of market building activities in the UK revolved around the creation of a diverse range of intermediaries. On the one hand, these intermediaries were in a position to win over new investor groups, and, on the other hand, the capital they managed enabled the creation of incentives for potential investees to implement social impact business models and find impact capital. The advantage of this approach was also that the intermediaries very quickly and impressively demonstrated the viability of social impact investing on the British market.

The pursuit of this approach led to the establishment of organisations such as Charity Bank (founded in 2002), which provided suitable financing instruments for charitable organisations, and the state-run Futurebuilders Fund (founded in 2004), which offered loans to charitable organisations and for-profit social enterprises that were unable to secure investment from the traditional lending market.

Above all, Bridges Ventures (founded in 2004) played a vital role: This investment company utilises strategies adopted from the traditional venture capital market in the impact investment space, thus demonstrating to traditional investors the viability of generating financial returns whilst simultaneously achieving proven social impact. In 2014 Bridges Ventures was managing assets of around 460 million British pounds. The company was not only one of the pioneers on the British SII market but also worked continuously on the broadening of its product portfolio and was thus able to win over new groups of investors: in addition to its initial Sustainable Growth Fund, which invests in for-profit social enterprises with high prospects for growth, and the Social Entrepreneurs Fund, which invests in social impact organisations with a sustainable business model, Bridges launched a Social Impact Bond Fund in 2013 and additionally manages three real estate funds.

In order to efficiently provide capital for the existing intermediaries and further promote market development, in 2012 the UK government founded the social investment bank Big Society Capital (BSC), which is also active in the development and dissemination of knowledge and best practice approaches in social impact investing and is committed to the long-term building of the market in the UK. The initial funding capital for BSC was obtained through the allocation of 400 million British pounds from dormant bank accounts and 200 million British pounds in contributions from the four main UK high street banks.39

Aside from providing funding for intermediaries, the government has also supported the creation of new financial products tailored to the investment needs of social impact-driven organisations. The development of financial products was monitored by various institutions, including the Next Steps fund, which paid out more than 3 million British pounds to initiatives that could demonstrate new financial products with a positive social impact. With this budget, social impact investments worth more than 20 million British pounds were leveraged.40 Since 2011 the UK government has been supporting the development of a charity bond market, which will enable trading in bonds issued by large charitable organisations. In addition, the development and launching of Social Impact Bonds as a new channel for social investment capital has also been promoted: whereas in 2012 there were two active Social Impact Bonds in the UK, in 2015 there were already 31, with about another 50 in the pipeline.41

Initiatives on the supply side were not explicitly at the focus of the market building strategy. The investor side, however, was implicitly strengthened through the promotion of robust intermediaries and through financial investment incentives.

The British task force recognised the key role of strong, diversified intermediaries with a sound investment track record, who are in a position to address a broad range of different types of investors. In the promotion of intermediaries and new products, particular focus was afforded to attracting financially strong institutional and private investors. In this way, Bridges Ventures succeeded in attracting pension funds, banks, foundations, private equity companies and enterprises as investors for its funds. At the same time, attempts were made to remove barriers to investment through tax incentives for investors (30 percent of social impact investment costs can be deducted from income tax)\(^42\) and by relaxing legal regulations for institutional investors.

On the capital demand side, targeted support was given in order to build the capacities of impact-driven organisations to win public contracts. In addition, assistance was given to civil society initiatives for the promotion of business start-ups.

The growth of the capital demand side took place somewhat later than the development of the intermediaries, but was also characterised by a highly strategic approach. The focusing on demand side impact-driven organisations as potential public service contractors is particularly noteworthy. From 2004 onwards, impact-driven organisations seeking to expand their capacity were assisted by the Futurebuilders Fund, which provided professional support in competing for contracts as public service contractors. The 10 million British pound Investment and Contract Readiness Fund (ICRF),\(^43\) established in 2012 by the Office for Civil Society, which is a unit of the Cabinet Office also seeks to promote the development of early-stage impact-driven organisations, which have often been overlooked in bids for public service contracts. A survey conducted by the Boston Consulting Group showed that services and payments totalling 8.9 million British pounds, made by the ICRF to 94 organisations, led to follow-on investments and the winning of public service contracts by the supported organisations worth 35 million British pounds.\(^44\)

Furthermore, the UK government supported or financed civil society initiatives for the strengthening of the capital demand side. The cooperation of the seven largest organisations which were actively promoting social enterprise in the UK resulted in the creation of the charitable organisation UnLtd in 2002. UnLtd. has capital resources of around 100 million British pounds and offers specifically tailored support in the form of networks, advice and coaching for early-stage social ventures. In addition, UnLtd can leverage investment capital from the public, philanthropic and private sectors in order to support selected social enterprises.\(^45\) The support of social ventures

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\(^{42}\) HM Treasury (2015).
\(^{44}\) Social Investment Business (2014).
was also fostered by the initiation of the Social Incubator Fund (founded in 2012), which provides numerous forms of support to social start-ups. Here, too, the impetus was provided by the Office for Civil Society, although the fund, which has resources of around 10 million British pounds, is administered by the Big Lottery Fund.\textsuperscript{46}

It is difficult to determine the precise number of social enterprises on the capital demand side owing to differing definitions. However, experts have demonstrated that the provision of support to impact-driven organisations by the public sector generated a knock-on effect in the SII market: for every 1 pound of public funds invested, social ventures received 38 pounds.\textsuperscript{47}

In order to enhance legal certainty for the participants in the market, a new legal for social enterprises was created in 2004: the Community Interest Company (CIC). CICs have the same structure as traditional companies, but they are obliged to use their assets for the public good and are subject to limitations regarding the distribution of dividends and the purpose-related allocation of capital (\textit{asset locks}). CICs have enjoyed very strong market acceptance— in the first year, 200 CICs were registered and in 2015 more than 11,000 registered CICs were already active.\textsuperscript{48}

\textbf{In its role as a catalyst and coordinator, the UK government has also contributed towards the development of a diversified market environment.}

As already mentioned, the UK government frequently acts as a stimulating force on the SII market. In order to strengthen the market infrastructure itself, the charitable organisation Social Finance UK was established in 2007. As a provider of advisory services, this organisation collaborates with the public sector, the social economy and the financial services industry in order to develop impact-driven solutions to intractable social problems. For instance, it was Social Finance UK that implemented the first Social Impact Bond in 2010.\textsuperscript{49} In addition, the government supported a large number of networks and organisations dedicated to coordinating and strengthening the British SII market— particularly noteworthy in this regard is the Social Stock Exchange (SSE), which was founded in 2013 in order to introduce the subject of social impact investing to a broader audience and attract investors.\textsuperscript{50}

\begin{flushright}
\textsuperscript{46} Big Lottery Fund (2015).
\textsuperscript{47} HM Government (2014), p. 5.
\textsuperscript{49} Social Finance (2015).
\end{flushright}
In addition to the public sector initiatives already mentioned in the spheres of market activity and the aforementioned impulses encouraging the development of the market infrastructure, the UK government has also scrutinised its own processes with regard to social impact investing. Two funds were founded to promote the development of Social Impact Bonds and the impact-related work of public authorities – the Social Outcomes Fund (founded in 2012) and the Pooled Outcomes Fund (founded in 2014), whose resources amount to around 20 and 30 million British pounds, respectively.\(^5\)

Simultaneously, the regulations on bidding for public sector contracts were changed in order to oblige public service contractors to take account of social and ecological impact as well as efficiency. The Social Value Act (passed in 2012) also enables social enterprises to have better access to public service contracts.\(^6\)

**Summary:** The example of the UK shows that strategic, coordinated measures and an active role of policymakers are necessary in order to further develop the SII market. The creation of a robust and diversified range of intermediaries is a key component to market building efforts.

Despite the differences between the social systems and the SII markets in Germany and the UK, it is clear that the strategic landmark decision by the government to assume a coordinating role, has been fundamental for the development of a viable SII market. Since the year 2000, a number of coordinated measures for the development of a robust and diversified range of intermediaries and the creation of new investment products has been promoted, incentives for investors have been generated, social enterprise start-ups have been supported through scaling-up programmes, and changes have been made to public service procurement practices in relation to impact-driven organisations. Owing to their mediating role between supply and demand, the development of the intermediaries has been particularly important: they have attracted new groups of investors, have created incentives for social enterprise start-ups and investment in them, and have successfully demonstrated the viability of social impact investing. In addition to funding intermediaries, it has been the change in the political and legal framework conditions, the provision of capital to selected organisations and the explicit support of new civil society initiatives that have been the key factor in the successful development of the market in the UK.

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VII. POSSIBLE ROLES FOR POLICYMAKERS IN THE DEVELOPMENT OF THE GERMAN SII MARKET

International comparisons highlight the important role of government in SII market building efforts. In the following section, we will therefore consider various policy options for Germany with regard to three key questions:

1. Why should the German state participate in the development of a national SII market?
2. What role could policymakers play?
3. What could possible starting points and specific first steps for state involvement be?

7.1. Why should the German state participate in the development of a national SII market?

Through the use of social impact investing, additional capital (beyond regular financing) can be generated for meeting social and demographic challenges, and through the focus on outcomes greater impact can be achieved by the capital flowing into the social sector.

At first sight, the idea of investing private investment capital in social organisations and impact-driven projects is difficult to reconcile with the state social welfare tradition in Germany and causes uncertainty on the part of the political actors. Nevertheless, from a policy-making point of view there are reasons to support the development of a market for social investment capital: In its final report, the German National Advisory Board stated clearly what the advantages for the federal government could be — the tapping of additional sources of finance in order to meet the social and demographic challenges that Germany will increasingly face in the coming years. Since state expenditure on health, education and social welfare is rising more quickly than the gross domestic product, considerable financial shortfalls are to be expected in future if the same standard of social services should be maintained. The German NAB has identified prevention in order to avoid follow-up costs to the state, innovation in order to develop new approaches to problem-solving, and the scaling-up of successful innovative projects, as areas that can contribute towards making up this shortfall. Every year billions of euros are already flowing into the German social economy, and complementary flows of capital could help to achieve greater impact for all involved actors.

State involvement in the SII sphere can act as a catalyst for existing civil society initiatives and by assuming a coordinating role it can shape the market environment for social impact investing.

The additional flows of finance needed to tackle future financial challenges can, however, only be used by political actors if there is a functioning German SII market where supply and demand are connected in an efficient way. In this early phase of growth, the state can have a stabilising effect by implementing a systematic promotional policy. Potential state involvement can build upon strong civil society initiatives which have already been working on building the market for years and can have a catalysing effect on these initiatives. As the potentially greatest beneficiary of a functioning German SII market, the government should be eager to collaborate actively in shaping this newly emerging market and its framework conditions in accordance with the public interest. This is particularly important since the state, unlike the forces of civil society that are currently active, is only beholden to the public interest.

The civil society actors alone are unlikely bring about the strategic and coordinated development of the market that is necessary in order to create a functioning SII ecosystem in Germany.

The growth expectations for the SII market are high, but in contrast to more highly developed markets in other countries, there are no systematic and strategic market building efforts in Germany. Such coordinated market building is hardly possible, however, with a predominance of very small actors, mostly funded by philanthropy, as is the case on the German SII market. A first step towards strategic coordination of the active organisations was undoubtedly the creation of the German National Advisory Board as a discussion platform and stimulus for the emerging SII market. The experience of the past few years has shown, however, that the German SII market can only develop slowly with this approach. Furthermore, the civil society actors who are engaged in market building do not have long-term financial resources and the legal and political scope for action that is necessary to establish a functioning SII ecosystem.

The German government has not yet adopted a position on the development of an SII market in Germany, but it does already support such investment strategies in development aid and the promotion of social entrepreneurship.

The German government has so far been reticent regarding the explicit promotion of the German SII market. In development aid, however, the federal government is heavily involved in the implementation and funding of SII instruments. The state-owned development bank KfW, for example, acts as an investor and provided know-how to support the launch of the world’s largest micro-finance fund EFSE. On the basis of its experience, the Federal Ministry for Economic Cooperation and Development (BMZ) has functioned as an SII Thought Leader and, in association with the Bertelsmann Stiftung, represented Germany in the Social Impact Investment Taskforce.
Furthermore, for the past few years the Federal Ministry for Families, Senior Citizens, Women and Young People (BMFSFJ) has been actively supporting early-stage social enterprises as social innovators within the framework of its Civic Engagement Strategy. Since financing has been identified as one of the most significant obstacles to growth for these early-stage organisations, in 2012 the BMFSFJ established the KfW co-financing programme in order to fill the gap in the existing financing spectrum available to early-stage social enterprises. When this programme came to an end, the federal government withdrew from the funding of the SII market for the time being, but continued measures to promote early-stage social enterprises (for example via start-up funding, such as the Social Impact Lab).

In mid-2015 the Federal Ministry for Economic Affairs and Energy commissioned a study entitled “Challenges in the establishment and scaling-up of social enterprises. Which framework conditions do social entrepreneurs need?” with the aim, in particular, of investigating the extent to which access to existing instruments for the promotion and financing of start-ups might be facilitated for non-charitable early-stage social ventures.
7.2. What role could policymakers play in developing the German SII market?

The following section considers policy options by examining the elements of a potential future supporting policy (Fig. 17) and the possible roles that the government could assume in the development of a functioning SII market (Fig. 18).

**Fig. 17: Elements of a possible market development policy**

<table>
<thead>
<tr>
<th>Institutional setting</th>
<th>Strategic principles</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Independent specialist agency on social impact investment</td>
<td>• Integrated supporting strategy</td>
</tr>
<tr>
<td></td>
<td>• Holistic approach</td>
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<tr>
<td></td>
<td>• Mobilisation of stakeholders</td>
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<td></td>
<td>• Transparency</td>
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</tbody>
</table>

**Areas of action**

The state in its role as:
- Investor
- Supporter of market infrastructure
- Legislator
- Procurer of social services
- Guarantor for social impact reporting quality

Source: own illustration.

An appropriate institutional setting is an important prerequisite for greater government involvement in the German SII market.

So far, it has been unclear where political responsibility for social impact investment lies among the various state actors. At present, three ministries (BMZ, BMFSFJ, BMWi) with different interests (development policy, promotion of social entrepreneurship, support for small and medium-sized enterprises) are all concerned with this topic to some degree. That is partly due to the fact that social impact investing is a cross-departmental issue. However, the concentration of responsibility and skills in one institution is an important prerequisite for the German government to be able to take an active role in building the market. A new specialist agency for social impact investment should be established as a separate department within a ministry or public authority. Close cooperation with the existing institutional structures and ministries, for example in the form of interdepartmental working groups, is a vital element of this endeavour. A key question is where this specialist agency should be situated. In order to lend this issue the desired political backing and attract the necessary attention, the UK government, for example, has located responsibility for developing
the SII market directly in the Cabinet Office. In Germany a specialist agency for social impact investment could likewise be established in the Federal Chancellor’s Office. What is important is that the specialist agency for social impact investment feels equally responsible for all segments of the SII market (e.g., charitable and for-profit investee organisations; investors and intermediaries).

The task of this specialist agency should be to formulate and implement policies and to promote the development of the infrastructure and the expansion of the sector. In order to ensure the transfer of expertise to such a specialist agency, a team of experts consisting of between six and ten highly qualified specialists working in the sphere of SII should provide guidance and advice. This team of experts could be recruited from the larger circle of members of the National Advisory Board. Its aim would be to advise the specialist agency on social impact investment and to draw up specific proposals for the strategic development of the market.

The basis for a successful development policy is a transparent, integrated strategy which takes a holistic approach to the promotion of the market and incorporates important stakeholders.

In addition to the aforementioned institutional framework for the involvement of the state, a strategy for building the SII market in Germany is required. In 2013, on the basis of international analyses, the Impact Investing Policy Collaborative drew up what are known as the London Principles for policymakers. Four of the principles set out there appear to be transferable to the German market.

1. **An integrated strategy:** The effectiveness of market-building strategies increases with better integration into broader social and financial policy objectives and existing legal structures. In particular, areas of overlap with existing strategies and programmes for the promotion of business and innovation should be reviewed. Possible German measures could also include coordination with established programmes of the European Union in this area (e.g., the Social Business Initiative).

2. **A holistic approach:** Adopting a holistic strategy can ensure the balanced development of supply (investors), demand (investees) and intermediaries. Isolated individual measures in one of these areas can have a catalysing effect on a certain outcome, but for the development of a whole ecosystem for impact-oriented investment capital they have so far brought only limited success.

3. **Mobilisation of stakeholders:** In drawing up a strategy for building the SII market, the public sector should regard itself as a catalyst which does not work in isolation but engages in dialogue with all important stakeholders in the market (for example, via the aforementioned team of experts). In this way, the key actors can articulate their needs and will subsequently be more willing to back policy decisions. The involvement of the stakeholders also promotes discipline.

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55 The Cabinet Office is a department of the UK government which is responsible for supporting the Prime Minister and the Cabinet with its ministers, helping to ensure effective development, coordination and implementation of policy and operations across all government departments.

and legitimacy in the political process and ultimately leads to more focused and practicable strategies that can be more easily implemented.

4. **Transparency:** Transparency denotes the setting of clear policy objectives and requires regular evaluation and reporting on progress in the implementation of the strategy and the measures associated with it.

The state can assume various roles in the development of a functioning market: as legislator, provider of infrastructure, investor, procurer of public services and possibly as a guarantor of the quality of impact reporting.

In the market development phase, the state can take on various operative roles in order to provide the necessary preconditions and incentives for the creation of a functioning SII market. On the basis of the analysis of state measures taken in the SIITF Member States, four roles have been identified in which the states can act as a catalyst for the advancement of the SII market: as legislator, as promoter of market infrastructure, as investor and as procurer of public services. In addition to these roles, experts in the field are also discussing the role of the state as a guarantor of impact reporting quality. In each of these roles the state can set different points of emphasis using various measures.
Measures for the promotion of infrastructure and investments in the market have already been investigated and in some cases implemented by the federal government.

In its role as a promoter of market infrastructure, the federal government has already supported measures to strengthen early-stage social enterprises, for example by funding the incubator Social Impact Lab. In addition, in connection with the aforementioned study commissioned by the BMWi the expansion of various advisory programmes to support social entrepreneurs is currently under consideration.

Within the framework of the KfW programme, which has now come to an end, the federal government has previously already acted as an investor in the German SII market. On the basis of the experience gained from this programme, it has been possible to draw up new successful programmes for injecting capital into the SII market. The extension of the applicability of existing instruments for the financing of start-ups, such as the Micro Mezzanine Fund and the Investment Subsidy Programme for Venture Capital, to social enterprises, which is currently being considered in the aforementioned study commissioned by the BMWi, would also fall within the category of this role. In addition, some actors on the market are calling for the establishment of a SocialTech Start-up Fund, similar to the existing HighTech Start-up Fund in the technology sector, for the early-stage financing of for-profit social enterprises. 58

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### POSSIBLE ROLES FOR THE STATE

<table>
<thead>
<tr>
<th>OBJECTIVE</th>
<th>POSSIBLE MEASURES (examples)</th>
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</thead>
<tbody>
<tr>
<td>Investor</td>
<td>Capitalisation of the SII market</td>
</tr>
<tr>
<td>Supporter of market infrastructure</td>
<td>Building a functioning market infrastructure</td>
</tr>
<tr>
<td>Legislator</td>
<td>Removing legal obstacles in the SII market</td>
</tr>
<tr>
<td>Procurer of social services</td>
<td>Increasing the effectiveness of social service delivery</td>
</tr>
<tr>
<td>Guarantor for social impact reporting quality</td>
<td>Harmonisation and objectivisation of social impact reporting standards</td>
</tr>
</tbody>
</table>

**Fig. 18:** Possible roles for the state in the development of an SII ecosystem

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A consortium consisting of Phineo gAG, Ananda Ventures GmbH and Bertelsmann Stiftung recently assessed the possibility of implementing such a fund.
As part of a coherent development policy, attention should be given to measures that the federal government can initiate in its role as legislator, procurer of impact-driven services and as a guarantor of quality in outcomes reporting.

To date, the federal government has not exercised its role as legislator in the sphere of social impact investing. The aim of any changes to legislative framework conditions could be to remove legal obstacles for investors or to promote social impact organisations. The promotion of investments by easing statutory regulations would correspond to the approach of the federal government in the sphere of renewable energies, for example. In its final report, the National Advisory Board suggested that the regulatory restrictions for institutional investors should be adjusted in order to facilitate social impact investing. Other statutory measures could aim to strengthen the legal basis of social enterprise as a business form for impact-driven organisations by adapting charitable status to the reality of the third sector (free distribution of profits and creation of reserves).

Every year contracts for the delivery of public services worth several billion euro are awarded by the federal government to the social economy in areas such as education, integration into the employment market and youth welfare services, in which private investment capital could potentially promote innovation, prevention and scaling-up of successful approaches in the form of Social Impact Bonds. In its role as a procurer of impact-driven services, the state could promote the creation of Social Impact Bonds, particularly for difficult target groups which existing state measures find hard to reach. Although Social Impact Bonds are not yet widespread in Germany and their implementation is complex, the use of this financing instrument could nevertheless promote greater effectiveness and impact-orientation in the delivery of state services, and by way of prevention it could bring about future savings for the public sector. Active state support for impact-driven financing models, for example through outcomes funds (see Chapter 6), could further promote the development of Social Impact Bonds.

One role of the state that was not looked into by the Social Impact Investment Taskforce but is already being discussed in specialist circles is that of the state as a guarantor of the quality of impact reporting. In the current market environment intermediaries (and sometimes also the investees) themselves take responsibility for reporting their impact, so far mostly based on proprietary methods of impact measurement and reporting. These actors, however, have a (commercial) interest in demonstrating as great an impact as possible. In order, firstly, to standardise reporting and, secondly, to make reporting more independent from those involved in the investment process, the state should step in. With regard to the introduction of guidelines for outcomes reporting, its role could be analogous to the standards that exist in financial reporting, with independent impact auditors being engaged.
7.3. What could possible starting points and specific first steps for state involvement be?

In order to broaden and diversify the market, it would appear sensible to adopt a holistic approach which aims at developing the market as a whole.

In Germany, only certain aspects of social impact investing, such as funding to support early-stage social enterprises, have been considered by policymakers to date. Yet this only reflects part of the impact investment market—in this case the high-risk financing of early-stage social start-ups. There is a risk that the SII market will remain restricted to isolated niches. A catalytic state policy could help the market expand—particularly into new asset classes—and lead to more impact-driven investment capital being directed towards the solution of social problems. In order to facilitate this, the objective of state promotional policy should be to strengthen all segments of the SII market: supply, demand and intermediaries.

At the same time, integration into existing systems in SME and start-up support, in social innovation and development aid would be sensible and necessary first steps in an SII promotion strategy.

Whilst a holistic approach to promotion is important for expanding and stabilising the market, it is just as important to integrate the subject of social impact investing into existing support systems in the relevant policy-making departments or ministries. Whereas the BMWi discusses the concept of SII primarily in connection with the support of start-ups (limited to for-profit organisations) and the placing of entrepreneurship at the heart of society, the BMFSFJ thinks of this topic under the headings ‘social innovation’ and ‘civic engagement’. For its part, the BMZ uses SII in the same way as other international actors, as a lever for increasing the effectiveness of financial resources for development aid. Other possible state actors are the Federal Ministry of Finance and the Federal Ministry for Employment and Social Welfare, which do not currently have their own strategies in relation to SII. Sensible first steps for the development of an SII market would therefore be to utilise these support systems and develop new measures that could act as a catalyst for the market as a whole. This can only be done, however, if the skills associated with the cross-departmental topic of social impact financing are concentrated in a single agency that is committed to the development of the SII market.

**Summary:** The federal government can play an important role in the development of a functioning SII market in Germany, and in view of the forthcoming demographic and social challenges, it should actively seek out this role.
From the point of view of the state, promoting a financial market in which there are few functioning models, and which has not yet been fully defined, might seem a bold endeavour. Ultimately, however, German policymakers ought to have an inherent interest in promoting new complementary sources of finance which can help to make up the anticipated financial shortfall in the social welfare sector. The speed at which these new sources can be tapped heavily depends on a well-targeted promotional policy, since the state is the only actor which has the financial resources and the necessary legal and political scope for action to have a catalysing effect on existing market activities and effectively push ahead the development of the German SII market. Specific starting points for a targeted promotional policy could be the existing support systems in the BMWi, BMFSFJ and BMZ. In order to develop the market in a strategic and coordinated way, however, it is necessary, above all, to concentrate skills in a specialist agency for social impact investment, where the policy guidelines for the strategic development of this sector can be formulated and implemented.
This report shows that the market for social impact investment in Germany has continued to develop at all levels over the past few years. More investors are investing capital with a view to social impact, the intermediaries are managing large amounts of capital and are actively working to broaden the range of products. More impact-driven organisations are seeking impact capital and are ready to use it, and the market infrastructure of advisers and service providers is now larger and more diverse than three years ago. Another noteworthy positive development is that some of the recommendations published in 2014 by the German National Advisory Board have already been implemented by the market participants. Although the current data situation does not allow for any exact market forecasts, the level of engagement and the funds and projects planned by the market actors clearly indicate that the German SII market is set to grow going forward. Based on the market participants and the products included in our survey, annual social impact investments may already reach 7 to 8 million euro in 2016. Furthermore, it is probable that new products and/or intermediaries will conduct additional investments, the value of which cannot yet be estimated.

At the same time, it remains true that the German market is still at an experimental stage, with annual investment volumes in the low single-digit millions, with a small number of actors on the supply and demand side, few investment products and high transaction costs. Whether the positive momentum that we have observed can be used for the building of a functioning ecosystem, and thus for the rapid further development of the market into a growth phase, will largely depend on whether the German government assumes a coordinating role in the strategic development of the market in the future. During this sensitive growth phase, the state is the only actor that has the financial resources and the legal and political scope for action to remove the obstacles and to act as a coordinator and catalyst for existing initiatives launched by private actors. As the example of the UK has shown, the coordinated and strategic promotion of the market is an important prerequisite for its further development and ultimately also for the answer to the question of whether the German SII market can reach a critical mass within the foreseeable future.
### ABBREVIATIONS

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>BA</td>
<td>Bundesagentur für Arbeit (Federal Employment Agency)</td>
</tr>
<tr>
<td>BDS</td>
<td>Bundesverband Deutscher Stiftungen (Association of German Foundations)</td>
</tr>
<tr>
<td>BMFSFJ</td>
<td>Bundesministerium für Familie, Senioren, Frauen und Jugend (Federal Ministry for Families, Senior Citizens, Women and Young People)</td>
</tr>
<tr>
<td>BMWi</td>
<td>Bundesministerium für Wirtschaft und Energie (Federal Ministry for Economic Affairs and Energy)</td>
</tr>
<tr>
<td>BMZ</td>
<td>Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung (Federal Ministry for Economic Cooperation and Development)</td>
</tr>
<tr>
<td>CIC</td>
<td>Community Interest Company</td>
</tr>
<tr>
<td>CSR</td>
<td>Corporate Social Responsibility</td>
</tr>
<tr>
<td>DACH-Region</td>
<td>Germany (D), Austria (A), Switzerland (CH)</td>
</tr>
<tr>
<td>EaSI</td>
<td>EU Programme for Employment and Social Innovation</td>
</tr>
<tr>
<td>EFSE</td>
<td>European Fund for Southeast Europe</td>
</tr>
<tr>
<td>EIF</td>
<td>European Investment Fund</td>
</tr>
<tr>
<td>EuSEF</td>
<td>European Social Entrepreneurship Funds</td>
</tr>
<tr>
<td>FASE</td>
<td>Finanzierungsgagentur für Social Entrepreneurship (Financing Agency for Social Entrepreneurship)</td>
</tr>
<tr>
<td>GIIN</td>
<td>Global Impact Investing Network</td>
</tr>
<tr>
<td>giz</td>
<td>Gesellschaft für Internationale Zusammenarbeit</td>
</tr>
<tr>
<td>HNWI</td>
<td>High Net Worth Individual</td>
</tr>
<tr>
<td>ICRF</td>
<td>Investment and Contract Readiness Fund</td>
</tr>
<tr>
<td>KfW</td>
<td>Kreditanstalt für Wiederaufbau</td>
</tr>
<tr>
<td>NAB</td>
<td>National Advisory Board</td>
</tr>
<tr>
<td>SIB</td>
<td>Social Impact Bond</td>
</tr>
<tr>
<td>SIITF</td>
<td>Social Impact Investment Taskforce</td>
</tr>
<tr>
<td>SSE</td>
<td>Social Stock Exchange</td>
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</tbody>
</table>
## Annex A: Overview of Interviewees

<table>
<thead>
<tr>
<th>Expert</th>
<th>Organisation</th>
</tr>
</thead>
<tbody>
<tr>
<td>01 Bernd Klosterkemper</td>
<td>Ananda Ventures GmbH</td>
</tr>
<tr>
<td>02 Ryan Little</td>
<td>BMW Foundation Herbert Quandt</td>
</tr>
<tr>
<td>03 Dorothee Vogt and Angela Lawaldt</td>
<td>BonVenture Management GmbH</td>
</tr>
<tr>
<td>04 Berenike Wiener</td>
<td>Association of German Foundations</td>
</tr>
<tr>
<td>05 Mareike van Oosting and Carl-August von Kospoth</td>
<td>Eberhard von Kuenheim Stiftung der BMW AG</td>
</tr>
<tr>
<td>06 Michael Unterberg</td>
<td>Evers &amp; Jung GmbH</td>
</tr>
<tr>
<td>07 Markus Freiburg</td>
<td>Financing Agency for Social Entrepreneurship GmbH</td>
</tr>
<tr>
<td>08 Volker Weber and Gesa Vögele</td>
<td>Forum Nachhaltige Geldanlagen e.V.</td>
</tr>
<tr>
<td>09 Roland Gross</td>
<td>Gesellschaft für Internationale Zusammenarbeit GmbH</td>
</tr>
<tr>
<td>10 Thomas Goldfuß</td>
<td>GLS Gemeinschaftsbank eG</td>
</tr>
<tr>
<td>11 Ingo Weber</td>
<td>Global Impact Investing Network (GIIN)</td>
</tr>
<tr>
<td>12 Niklas Ruf</td>
<td>Juvat gGmbH</td>
</tr>
<tr>
<td>13 Klaus Müller</td>
<td>KfW Bankengruppe</td>
</tr>
<tr>
<td>14 Björn Strüwer</td>
<td>Roots of Impact GmbH</td>
</tr>
<tr>
<td>15 Norbert Kunz</td>
<td>Social Impact GmbH</td>
</tr>
<tr>
<td>16 Franziska Schaefermayer</td>
<td>Tengelmann Ventures Management GmbH</td>
</tr>
</tbody>
</table>
ANNEX B:
LIST OF ORGANISATIONS ON THE GERMAN SII MARKET

Intermediaries

Ananda Ventures GmbH
BonVenture Management GmbH
GLS Gemeinschaftsbank eG
Juvat gGmbH
Tengelmann Ventures Management GmbH

Market environment

Market development
Ashoka Deutschland gGmbH
Bertelsmann Stiftung
BMW Foundation Herbert Quandt

Research
Centre for Social Investment, University of Heidelberg
University of Hamburg
University of Stuttgart
Zeppelin University

Networking/Lobbying
Financing Agency for Social Entrepreneurship (FASE)
Global Impact Investing Network (GIIN)
TONIIC

Product development and investor advisory services
Financing Agency for Social Entrepreneurship (FASE)
Golden Deer
Phineo gAG
Roots of Impact GmbH
SIC gGmbH

Support/advisory services for impact-driven organisations
Ashoka Deutschland gGmbH
Impact Hub
Social Impact GmbH
Social Entrepreneurship Akademie
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Progress Report: Tracking Taskforce Recommendations.
http://socialimpactinvestment.org/reports/Tracking-Taskforce-Recommendations-Stephen-Brien.pptx

FAQ Expertenkreis Impact Investing.


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