An Introduction to Quasi-Equity or Revenue Participation Agreements

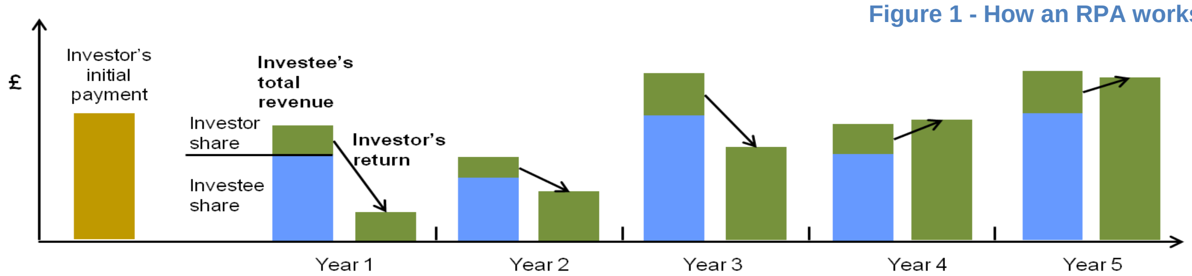
What are they?

Quasi-equity or Revenue Participation Agreements are a type of financial instrument that allow both the investor and investee to share the risk and reward of enterprise more flexibly than debt allows and in situations in which equity financing is not possible.

How do they work?

In practice, quasi-equity is implemented through the sale and purchase of a Revenue Participation Right. This provides the investor with the right to a percentage share in the revenue of the enterprise (not profit, because for most investees profit will not be the prime motivation, and there is potential for manipulation of profitability). The amount payable under the RPA is usually capped (at twice the amount invested and/or limited to a fixed time period). The amount repaid is proportionate to the revenue, so can decrease (shown by fig.1).

Figure 1 - How an RPA works



Why would a mutual use them?

- They can be used in situations in which share capital is not possible, for example, Community Interest Companies or companies limited by guarantee
- It is patient capital – if the enterprise performs badly, the amount repaid is reduced
- The risk and reward of the investment is shared between the investor and the investee
- Providers of equity capital tend to want a clear way to recoup capital, through an exit strategy. An RPA does not require this. It is also less expensive and quicker than raising equity finance

What are the disadvantages?

- The amount received will be accounted as a liability on a mutual's balance sheet
- RPAs are relatively risky for investors, and consequently they are likely to want larger total returns
- Track record tends to be a precondition to investment; they are not a suitable instrument for start-ups
- They are structurally complex instruments (compared to debt) because of the need for agreement on revenue (particularly if ring-fencing a portion of revenue as part of the RPA)
- Investors tend to want more control compared to debt; this may include a board seat
- Investment tends to be longer-term compared to debt; a closer relationship is required with investors

Who offers them?

Big Issue Invest can provide £50,000 - £1m loans (www.bigissueinvest.com)
Bridges Ventures: Social Entrepreneurs Fund invests up to £1.5m per investment, in social enterprises. Venture Funds invest £500,000 - £10m in ambitious growth businesses. (www.bridgesventures.com)
CAF Venturesome can offer £25,000 - £250,000 RPAs for small and medium-sized charitable organisations (www.cafonline.org/charity-finance--fundraising/banking-and-investments/loans-and-capital.aspx)
Social Investment Business can provide £50,000 - £1 million quasi-equity facilities (www.thesocialinvestmentbusiness.org)

Where can I find more information?

CAF Venturesome: https://www.cafonline.org/pdf/VenturesomeQuasiEquityMarch2008.pdf
National Council for Voluntary Organisations: http://www.knowhownonprofit.org/funding/social-investment-1/investment-types/quasi-equity-revenue-participation

*Please be aware this note is for general information purposes, and is not meant to be a definitive guide. Readers should seek independent professional advice on their individual requirements.