THE ENTERPRISE DEVELOPMENT TOOLKIT:

SUPPORTING CLEAN COOKING ENTERPRISES ON THEIR JOURNEY TO SCALE

GLOBAL ALLIANCE FOR CLEAN COOKSTOVES

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INTRODUCTION AND EXECUTIVE SUMMARY

Since its launch in 2010, the Global Alliance for Clean Cookstoves (Alliance) has achieved significant progress in its market-enabling activities, including: established multiple funds to support the development of commercially viable enterprises and encourage innovations in design, manufacturing and distribution of clean cookstoves and fuels;, supported regional testing and knowledge centers (RTKCs) in 13 countries across Africa, Asia, and Latin America; led a process to create the first-ever international guidelines for cookstove safety, efficiency, and cleanliness; launched Country Action Plans in its eight focus countries; grew its partnership from 19 partners to more than 1,000 active partners; commissioned 19 market assessments and 3 consumer segmentation and preference studies; and directly and indirectly supported numerous competitive research grants in the areas of child survival, climate change, fuels research, gender impacts and clean cookstove and fuel adoption.

The Alliance also remains committed to serving as a resource and knowledge hub for the sector, with a particular focus on helping all of our country partners make progress in developing their own thriving markets for clean cookstoves and fuels. To this end, in 2013 we published our *Partner Country Toolkit* [http://www.cleancookstoves.org/resources_files/partner-country-toolkit.docx], which describes a ten-step process to further develop the improved cookstoves and fuels markets in our partner countries. This guide builds on the partner toolkit and expands on *Step 6: Drive Investment and Scale Enterprises to Meet Consumer Need*.

Increasing investment in the clean cooking sector is critical to realizing the Alliance's goal of 100 million households adopting cleaner and more efficient stoves and fuels by 2020. In the sector report *Igniting Change: A Strategy for Universal Adoption of Clean Cookstoves and Fuels*, stakeholders cited access to finance as the primary barrier for the scaling up of clean cooking technologies globally.

Yet, despite decades of work by hundreds of organizations active in the sector to increase adoption of clean cooking solutions, the market remains under-developed and highly fragmented. The majority of enterprises across the cookstove and fuels value chain are small and medium enterprises (SMEs). Due to the fragmented nature of the sector, many players are attempting to work across the entire value chain, stretching resources rather than focusing in an area that leverages their strengths. Those that do try to specialize often find it difficult to identify the right partners.

Although there have been investments in clean cooking enterprises, and interest in the sector continues to grow among early stage impact investors, the lack of financing at scale to the sector remains high due to:

- **Early stages of maturity of the clean cooking sector:** The majority of impact investors look for market conditions that lend themselves to scale. This includes clear standards for assessing and benchmarking product performance, demand for the product, and an enabling policy environment. The reality in the clean cooking sector—lack of standards, low awareness of the benefits of clean cookstoves and fuels, and high import tariffs for raw materials and finished products—is a higher risk proposition for investors.
- **Lack of "investment ready" businesses:** Most clean cooking enterprises are at an early stage of development and need long-term capital, as well as business development assistance. Capacity building needs depend on the enterprise and range from marketing strategy to streamlining manufacturing to budgeting and business planning. Few impact investors are willing to provide money and technical assistance to early stage companies.
- **Lack of knowledge about the clean cooking sector:** Many investors and financial institutions, including domestic and international banks, as well as microfinance institutions, have little or no knowledge of the clean cooking sector.

In order to drive investment into the sector, the Alliance is working to support the development of commercially viable and scalable enterprises. Our full investment strategy to support the sector can be found at http://www.cleancookstoves.org/resources_files/alliance-strategy-drive-investment.pdf. We have prepared this toolkit to share the steps we took to address the barriers to investment and the lessons we learned on our journey to help enterprises prepare to access commercial capital to scale.

Enterprise development in the clean cooking sector requires a combination of capacity building and financing to help businesses reach a size and stage of maturity that allows them to attract investors. The toolkit describes the Alliance's approach to enterprise development in four sections:

1

ENTERPRISE DEVELOPMENT GPS: HOW TO DETERMINE YOUR STARTING POINT

Financing and capacity building programs need to be tailored to clean cookstoves and fuels enterprises at different stages of development. This section discusses how to identify an enterprise's stage of growth.

2

FUELING THE ENTERPRISE: HOW TO DETERMINE THE RIGHT TYPES OF FUNDING

Financing for enterprises ranges from early stage grant funding, through subsidized capital, to angel equity, and ultimately to commercial capital. This section highlights which funding sources are most appropriate for an enterprise at each stage of growth.

3

HITTING THE ROAD: HOW TO DEVELOP AND IMPLEMENT FINANCING MECHANISMS FOR ENTERPRISES

Grants are a valuable source of financing for early stage companies in order to create a pipeline of companies that can attract investment. This section goes into detail on how to implement grant financing mechanisms for enterprises and how to form strategic partnerships to increase access to finance for clean cooking enterprises.

4

SERVICING THE ENGINE: HOW TO BUILD CAPACITY

Enterprises need more than just finance to support their development. This section focuses on how to strengthen the operations, strategy, systems, and processes of an enterprise through capacity building.

These sections are not steps in a process but rather critical elements of a successful road trip. The first two sections present information that prepares you for the road trip, while the third section discusses the journey of financing clean cooking enterprises, and the fourth section on capacity building keeps you on the road to scale. Thus, capacity development is a complement to the journey, not a step to be taken after financing a company. The hope is to take you from the starting point of a highly fragmented clean cooking sector, to the final destination of scaled enterprises providing a strong supply of clean cooking solutions in your market.

1

ENTERPRISE DEVELOPMENT GPS:

HOW TO DETERMINE YOUR STARTING POINT

The enterprises operating within a market to design, manufacture, distribute, retail, and finance clean cookstoves and fuels vary by size and capacity and thus have different needs when it comes to financing and capacity building. Before designing programs or funding mechanisms, the Alliance starts by assessing the unique needs of the group of enterprises it is targeting. The enterprise growth stage is the GPS on the enterprise's road trip to growth. In other words, it helps you locate the starting position of the market and individual enterprises before beginning the journey of scaling the sector.

What you'll learn in this section:

- ➤ How growth stage of an enterprise affects enterprise development support
- ➤ The characteristics of clean cooking companies at each stage
- ➤ How to conduct a growth stage analysis across a defined market

1.1 Growth Stage Assessment

The Alliance defines four stages of enterprise development: Start-up, Venture, Growth, and Mature. There are no hard and fast rules to these definitions; some documents and organizations will call these stages by different names or break out the stages into five parts. To determine growth stage, the Alliance takes a careful look at the company's operations in the areas of management, strategy, sales and marketing, financial systems, management information systems, and product development. While most companies have some growth stage variance across areas of operation, the table below highlights the key characteristics of clean cooking companies that the Alliance has seen at each growth stage. The table looks very different from a growth stage guideline for traditional for-profit companies because it takes into account the immature nature of the clean cooking sector.

Characteristics of Social Enterprises Through the Growth Stages

Start-up	Venture	Growth	Mature
• Sales are minimal or may not have occurred yet • Core technologies or service offerings are still in development • Consumer needs are still being assessed • Customer sales trials	• Sales begin but do not sustain the organization's operations • The business model and plan are still being developed and adjusted based on realities of the market • Cost, value, and pricing are still in flux • Educating the consumer and below the line marketing activities	• Sales sustain initial operations but not growth • Business model is functioning, and focus is on expansion into new geographies or product/service offerings • Organization has implemented some systems to build organizational capacity to scale • Company has built up consumer demand	• Company is profitable • Brand is developed and recognizable • Systems, assets, and talent are in place, or company continues to invest in these areas • Company expands into new geographies or product/service offerings to capitalize on opportunities • Strategic planning is embedded in the business activities

Now that you have a basic working definition of the growth stages, you can begin to assess where the enterprises within your market fall along this spectrum and strengthen the planning for enterprise support programs. The Alliance has developed a tool and process for enterprise assessment that complements the understanding of the clean cooking sector provided in the table above.

1.2 TOOL: Growth Stage Assessment

The Alliance has expanded the growth stage analysis above to include a growth stage assessment tool. The tool offers a growth stage distinction across eight areas of operations and acknowledges that enterprises will have different financial and staff requirements depending on their stage of growth. As shown in the SimGas case study later in this section, an enterprise can vary in its stage of development across different areas of operations, and understanding this allows programs to be customized to ensure an individual enterprise receives the support it needs.

USES OF THE GROWTH STAGE ASSESSMENT TOOL

- Helps an enterprise better understand its strengths and areas for development through different operational categories
- Helps determine appropriate funding at the enterprise level, or can be aggregated at the market level to create support mechanisms
- Can identify where trends lie amongst clean cookstove enterprises within a particular region, and can help donors and investors fund accordingly
- Helps determine appropriate capacity building support in conjunction with information in following parts of this toolkit
- Can eliminate inefficiencies that arise from an enterprise receiving funding that is not suited for its current growth stage or potential

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Instructions: Choose the stage that best represents the enterprise in each area of operations. Only one stage can be chosen for each. Please note that this is simply a self-assessment tool, not a final indication of the enterprise's growth stage.

Management Style	Seed/start-up stage	Owner/Director supervises all staff.
	Venture stage	Owner/Director oversees day-to-day activities by supervising a few key individuals.
	Growth stage	Functional organizational chart with separation of administrative activities and key business activities.
	Mature, private companies	Owner/Director oversees divisions and focuses on growth.
Management Experience	Seed/start-up stage	Owner or team is a subject-matter expert with little experience running an organization OR owner/team is a business professional that may be new to the subject matter or emerging/pioneer markets.
	Venture stage	Team has some relevant experience in management; some relevant capabilities from other fields in business and non profit mangagement. Team exhibits some experience with their operating environment.
	Growth stage	Team has significant experience in non-profit, social enterprise or for-profit management.
	Mature, private companies	CEO/Director has significant management experience, particularly in the field appropriate to the business. Lead team includes senior financial, administrative, and operations personnnel.
Extent of Financial Systems	Seed/start-up stage	Grants and sales deposited and acknowledged, bills paid, supporting documentation collected/retained. Likely to have a bookkeeper and owner manages finances
	Venture stage	Financial activities transparent, clearly and consistently recorded and documented, include appropriate checks and balances, and tracked to approve budget. Likely a financial manager and bookkeeper in place.
	Growth stage	Formal internal controls governing all financial operations; fully tracked, supported and reported, annually audited fund flows well managed; attention is paid to cash flow management. Likely a financial manger, controller and/or bookkeeper in place.
	Mature, private companies	Robust systems and controls in place governing all financial operations and their integration with budgeting, decision making and organizational objectives/strategic goals; cash flow actively managed. Likely a CFO is in place.
Major Strategy and Planning	Seed/start-up stage	Existence. Business is focused on obtaining customers and delivering product. Adjustments are still being made to the business model. Formal planning and strategy are minimal to nonexistent.
	Venture stage	Survival. Business is finalizing the model and growing sales. Some planning may be done and dictate management decisions. Data collection on sales may inform strategic plan.
	Growth stage	Strategy around maintaining profitability and getting resources for growth. Ability and tendency to develop and refine concrete, realistic strategic plan; some internal expertise in strategic planning or access to relevant external assistance; strategic planning carried out on a near-regular basis; strategic plan used to guide management decisions. Organization most likely uses sales, pricing and supply chain practices integrated into planning.
	Mature, private companies	Maturation: Use of extensive data and market analysis to develop and refine concrete, realistic and detailed strategic planning; critical mass of internal exptertise in strategic planning, or efficient use of external, sustainable, highly qualified resources; strategic planning exercise carried out regularly; strategic plan used extensively to guide management decisions.
Marketing Strategy	Seed/start-up stage	Marketing is focused on product/service development tailored to the market, establishing price points, etc.
	Venture stage	If the product is in a push market, where the potential customers must be educated on the product, educational campaigns and market preparation are in development.
	Growth stage	If the product is in a push market, education of potential customers still remains the primary focus. Branding of the product has begun, and pricing is near complete.
	Mature, private companies	Brand has been established and is trusted by the community. Company has found the right marketing mix (product, placement, pricing, promotion) that has made products or company synonmous with trust and functionality. Company has succeeded at educating the population on the benefits of the product.
Product Development	Seed/start-up stage	Flagship product or product offering is still in the R&D stage. The product may be developed and functional, but may not be proven in its intended market.
	Venture stage	Flagship product design is nearly complete, but R&D may still need to be completed on complementary product or service offerings that would improve updake and the business model.
	Growth stage	Product and complementary products and services are nearly complete. Manufacturing and distribution processes may still be in development, and there could be problems with the supply chain.
	Mature, private companies	Products and services are fully developed, and manufacturing processes are finalized and streamlined although there may be some room for improvement.
Management Information Systems (technology, people and data)	Seed/start-up stage	Systems do not exist and may not be in place. Data is tracked by hand or through a similar tool such as an Excel spreadheet.
	Venture stage	Some tracking of sales and accounts receivable/payable. There may be systems in place for carbon management.
	Growth stage	One or more software based programs manages sales and finances. Systems may not be very complex but can provide data, based reports.
	Mature, private companies	Systems are in place to manage technology, people and data. They inform sales and strategy. Systems are regularly used by all required personnel and provide added value to the bottom line.
Sales	Seed/start-up stage	Sales of less than 10,000 stove/customers. Firm focuses sales on a small area for distribution, within one country.
	Venture stage	Sales of at least 20,000. Business has more than one geographical focus but has not achieved significant market penetration in either. Market share is significantly lower than 10%.
	Growth stage	Sales are between 20,000 and 100,000.
	Mature, private companies	Sales of more than 100,000 cumulative units in Africa and Latin America, 1 million in densely populated Asian countries or for global operations.

[http://www.cleancookstoves.org/resources_files/revised-growth-stage-assessment.xlsx]

As demonstrated by the tool, enterprises can be at a growth stage in an area such as their management team while still in a venture stage in another area, like product development. The tool addresses this variance by providing an output of a final, average growth stage. Even though the Alliance has used this tool as a guide to begin program development, we have learned that enterprises may still need support at different levels than what is determined in the assessment. More on this can be found in the SimGas case study.

1.3 REALITY CHECK: The SimGas Case Study

The Alliance's Spark Fund grantee SimGas BV is an example of an earlier stage company that needed later stage support to grow its operations. SimGas BV is a biogas digester company with operations in Kenya, Tanzania, and the Netherlands. When they applied for funding in 2013, they had served approximately 900 customers, but had aspirations to achieve the sales of more than 10,000 units by early 2015. Their growth plans included redesigning some of the components of their biodigester, investing in vehicles to improve distribution efficiency and reduce costs, and expansion into new markets.

In most categories of the growth stage assessment, SimGas was assessed as a venture stage company. Their flagship products still required additional design tweaks, they were still refining their target market and sales strategy, and their sales volumes were relatively small. However, their employee base was growing fast due to the nature of their business as a manufacturer, distributor, marketer, and after sales service company. They required more research and development funding and capital expenditures to implement their growth plans than a typical venture stage company, and the Alliance funded them at a growth stage level.

SimGas

1.4 Idea in Practice: Conducting Growth Stage Assessments as a Baseline for Programming

To inform the design of funding mechanisms, the Alliance has used the growth stage assessment tool to conduct an analysis on a sampling of companies in a market. To identify the companies for the sample, you can utilize these Alliance's open source tools:

- The Alliance partner directory [http://community.cleancookstoves.org/partners/directory.html] allows you to search for partners by type and location.
- The Alliance has market assessments for about 18 countries globally [http://www.cleancookstoves.org/resources/reports-and-research/?alliance_reports_research=alliance-market-assessments]. Most market assessments have an overview of the principal actors in the clean cooking value chain.

In order to complete the assessment, we recommend a site visit of at least three hours, but preferably one day, per enterprise to gather the information that will enable you to fill out the growth stage assessment tool. The assessor should take time to visit production sites, view a sale, understand the organizational culture, and understand how data is collected and analyzed. Here are a few examples of interview questions that will help you complete the growth stage using the tool provided. Some of these questions are broad because this assessment is meant to be a conversation. Also, the answers to these questions may provide insight into multiple areas of the company's operations.

When was your company founded? What is your background?

- How many employees do you currently have? How many are in management roles? How many employees report to the CEO?
- What people or skills have you added to your team since the business was founded?

What infrastructure have you put in place for accounting and financial management?

- Can you walk me through the billing/payment processes?
- Can you walk me through what data is collected when a sale is made and the processing of money and information?

What business planning have you done? Strategic planning?

- What are your company's growth initiatives going forward?

Do you have a board of directors? If so, what kind of interaction do you have with them?

What marketing have you implemented? What challenges have you faced in marketing?

- What are your sales in units and revenue figures this year? Last year?

How has your product changed over time? What steps have you taken to improve the production or distribution process?

Detailed notes and photos should be taken during the assessment process. The Alliance usually supplements the completed Excel tool with a narrative on the assessment that discusses what was seen during the site visit. The assessor should follow-up after the visit with any questions that remain unanswered and share the final report with the company as a capacity development tool.

Once the assessment is completed for all of the enterprises in the sample, the results can be aggregated across the sample and analyzed to map out the growth stage for enterprises in the market. This aggregation of analysis can identify trends in specific areas of operation, such as management, strategy, sales, and product development. The assessor can then give an overview of the stage of development and operational gaps of a pipeline of clean cooking companies requiring support within a market. For example, when the Alliance conducted these assessments in early 2013 in Kenya and Uganda, most of the enterprises were start-ups and venture stage companies. The flagship Alliance grant at the time, the Spark Fund (discussed in depth in section three), was structured to only support larger, growth stage companies. The Alliance was able to use this analysis to restructure the Spark Fund to support earlier stage companies. Thus, the growth stage will help determine the types of funds and capacity support needed in the sector. This will be discussed in more depth in the forthcoming sections.

Although the growth stage assessment tool can be used to map out the growth stage for enterprises in the market and identify trends in specific areas of operation, the Alliance, at times, has used a more in-depth assessment to analyze the sample of enterprises. The in-depth assessment is done per the process outlined in this section, but can include a stronger financial and operational analysis to enhance the development of funding and capacity building programs outlined in sections three and four of this document. Similar to the growth stage assessment, the results of the in-depth analysis are aggregated across a market. This process uses a modified version of the due diligence template provided in section three, and examples of this process in action can be seen in the Ghana Catalytic Small Grants case in section three as well. You can access the in-depth analysis template here: http://www.cleancookstoves.org/resources_files/in-depth-analysis-template.xlsx.

1.5 Idea in Brief

The enterprises that are active across the cookstove and fuel value chains range in size and capacity, and each one has specific needs in order for the company to grow and achieve its potential. Before designing programs or funding mechanisms, it is important to understand the unique needs of the group of enterprises you are targeting. In addition to conducting a simple assessment on a sample of enterprises in the sector, an enterprise development organization can assure it better understands the financing and capacity needs of enterprises through an in-depth enterprise analysis and aggregating the results from across a market.

Jessie Durrett

2

FUELING THE ENTERPRISE:

HOW TO DETERMINE THE RIGHT TYPES OF FUNDING

Now that you have determined where the enterprises within the market are starting, the next step is to ascertain the right amount and type of financing for the journey to further develop and grow the companies. In this section, we present an overview of the types of capital that the Alliance has seen deployed in the sector at each growth stage. We then discuss ways to determine the right funding fit, always remembering that these overviews can and should be strengthened by taking a close look at the companies and financials of each.

What you'll learn in this section:

- **The types of financing that clean cooking companies typically access at various stages of development**
- **How to decide what type of financing is appropriate**

2.1 Financing Instruments

The aim of this section is to explain the complex mix of grants, debt, and equity that fund a company's path to growth. First, we will define the types of financing and identify typical challenges to accessing them in the clean cooking sector. If you are already familiar with the different types of financing, you can skip to section three, which outlines how to design and implement funding programs.

- **Grants** are funds that do not have to be repaid by the enterprise, but are usually tied to restricted activities. A mission fit between the donor and the enterprise is required, and it can be expensive to apply for and/or manage grants, depending on the donor.

  Challenges: Grant funding is limited, relative to other types of capital, and is not always flexible, depending on the donor.

- **Equity investment capital** is financing in exchange for ownership stake in a company. When a company receives equity financing, it is being paid a sum of money for a determined percentage ownership of the company. This scenario in the clean cooking sector usually involves private equity investors. For a variety of reasons, clean cooking companies will not be publicly trading equity ownership or "shares" in the near to medium term. A private equity investor usually requires representation on the board of the company, but this also adds value to the company in the form of mentoring and professional contacts. While the equity investor or investment fund may not expect payments on a regular basis, it will expect to get repaid its full investment amount with a sizeable return on the investment.

  Challenges: An equity investment requires that the investor and the enterprise agree on a current valuation of the company and that the investor can exit the company—in other words, sell their share to recover their initial investment and make a profit in the medium term. A valuation for a social enterprise that is operating in an unproven market is usually low. As a result, the investor could receive a majority ownership of the company—something that is usually not agreeable to the investor and the entrepreneur. The exit of the company at a profit is not yet proven in the clean cooking sector, and without examples of successful exits, investors believe that equity is too risky.

- **Debt** is a loan that has to be repaid, but the terms of the loan can vary dramatically. An enterprise can take out revolving lines of credit or fixed loans based on their needs and repayment period. The borrowing organization usually has to pay interest payments in addition to payments on the principal, on a regular basis.

  Challenges: The enterprise must be generating a consistent and positive cash flow in order to reasonably qualify for debt. In many local financial institutions, the enterprise must provide collateral to secure the loan. Furthermore, interest rates in many emerging markets are too high for early stage enterprises to reasonably make payments.

- **Quasi equity** straddles the line between debt and equity and can take many forms including convertible notes, mezzanine financing, subordinated debt, royalty repayment arrangements, and preference shares. Quasi equity instruments are structured as debt and have repayment terms, yet have some participation in the upside if the company is successful. More detailed definitions of these terms can be found in the glossary.

  Challenges: Since quasi equity instruments are structured like debt, the challenges are also similar. Also, since quasi equity investors expect to participate in the upside of the business in the event of success, the company needs to be able to reasonably demonstrate high growth potential.

In addition to the four broad types of funding or asset classes defined above, there are a few terms that will be mentioned later in this section:

- Recoverable grants are actually zero-interest loans. They do have to be repaid, but interest is not charged, and repayment terms are often flexible.
- Concessional loans are loans with very flexible repayment terms and low interest rates. This subsidized financing is usually provided in order to support a particular mission or catalyze a particular market or sector.

The enterprise's stage of development can help determine in broad terms what kind of financing is appropriate. The table below lays out the characteristics of each funding type, the characteristics of the enterprise that is able to access that type of funding, the implications for the enterprise, and the types of organizations that can provide funds. This table is helpful in preparing to use the tool in the next part of this section.

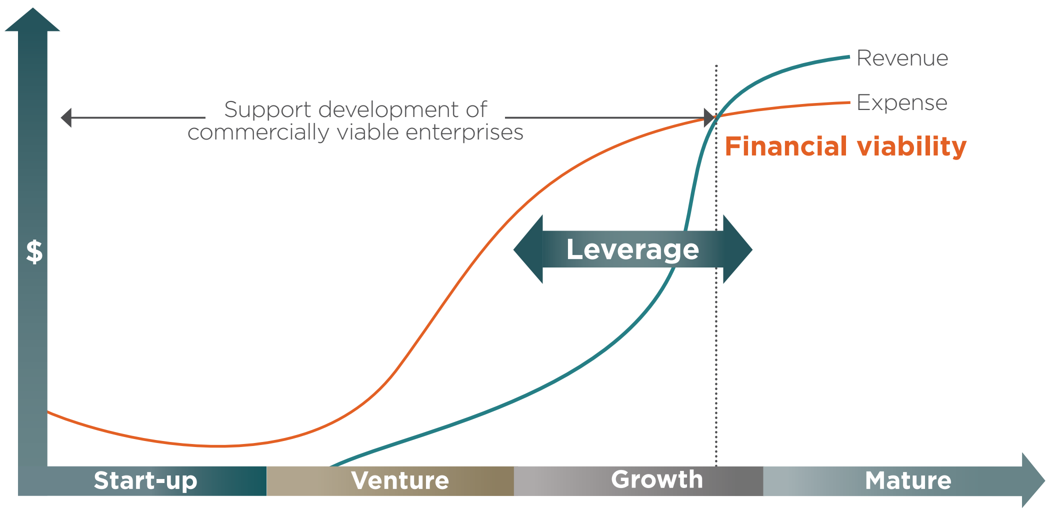
Financing Instrument	Financing Characteristics	Business Characteristics	Implications for Social Enterprise	Types of Funders
Grants	Donor does not participate in the upside if business is successful Donor is not repaid Donor does not have control over company, recourse if company fails or rights to assets	Business is usually not yet profitable Business has a social mission There is a relationship and trust between donor and business	Usually restricted funds Fundraising costs are high Usually limited flexibility*	Bilateral aid agencies Foundations Individuals
Debt Capital	Lender does not participate in the upside if business is successful Fixed payment schedule and terms Lender does not have control over company Lender is paid first in an event of business failure	Established Proper financial documentation Predictable cash flow Sometimes collatoral	Interest payments require low risk or established business model Ownership of the business is not diluted Capital providers can obtain and liquidate assets in the case of a default Entrepreneur has flexibility in the use of capital	Local financial institutions International financial institutions Development Finance Institutions Investment Funds or Individuals
Private Equity Capital	Investor participates in the upside if business is successful No fixed payment No collatoral is required Investor receives ownership rights and usually seat(s) on board Limited recourse- owners get paid last in case of failure	Earlier stages of development Businesses is poised for high growth and expansion There is usually a planned exit for the owners in order to recoup investment Business has a legal structure that allows it to sell stakes in the company	Dilution of ownership Social investor receives control and voting rights Potential impact on corporate culture	Development Finance Institutions Investment Funds or Individuals Angels Accelerators and incubators
Quasi-Equity^	Flexible repayment options Unsecured No ownership unless converted into equity Blend of debt and equity, depending on the instrument	Ranges from early stage to established Investors could have a claim on the company assets in the case of default	Regular interest/ royalty payments require predictable income or cash flows Ownership is diluted only if/when it is converted into equity Profits are shared with the impact investor	Investment Funds or Individuals Development Finance Institutions Angels Accelerators and incubators

* The Alliance recommends funding business plans as opposed to projects and leaving room for flexibility should the business plan change. See Spark Fund structure case study in section three.
^ Quasi-equity in this table is defined to include instruments such as high yield debt, royalty models, mezzanine financing, convertible debt and preference share.

SimGas

2.2 Financing Through the Growth Stages

Now that the definitions and challenges for different financing options are defined, we can begin to understand how financing can be deployed at varying stages of development. When the financial position of a clean cooking company is considered alongside the stages of development, the challenge the clean cooking enterprises face is clear: expenses run higher than revenues for the first few stages of growth. In fact, the start-up stage company does not generate revenue yet, since it is likely developing a product and business model. Venture stage companies are defined as post-revenue, meaning that they sell a product or service, but have not likely started to generate a positive cash flow. In other words, the expenses are still higher than revenues. The company reaches breakeven



when they have a positive net income, which is the amount of money left over after expenses, taxes, interest, depreciation, and amortization. The goal of enterprise development programs is to get enterprises to breakeven, and eventually profitability so they have money to reinvest in growth and to attract investment for growth. As noted in this chart, the Alliance provides support through to the growth stage and expects to leverage its support with impact investing. Guidance on this process is discussed in section three.

Seed funding for start-ups often comes from the founder, friends, or family, but it can also come from foundations or non-profits, or in some cases from an individual investor. This capital can take any form, meaning debt, equity, or grants. Often, repayment of the initial investment and the return on this investment cannot be generated until the enterprise reaches the breakeven point. Start-up enterprises need to make sure their seed funding supports them until the business is strategically positioned to qualify for additional financing.

Enterprises in the venture and growth stages are typically funded by a combination of loans, and equity. Traditionally, international development organizations and governments have provided incentives for local banks to give loans to enterprises in the venture and growth stages, but in many cases, other forms of financing are also needed. In order to manage debt financing from a bank, the enterprise needs sufficient cash flow to cover day-to-day operational costs and to service the debt, plus interest from a bank loan. At this stage in the clean cooking sector, the Alliance has seen the need for grants to continue to be a part of the funding mix. The sole reliance on return-seeking capital investments can be problematic. Grants do not need to be used in isolation from investment capital.

Although grant investments are vital at these stages, the Alliance has also sought out investors who are comfortable with lower rates of return than expected of traditional investors in private companies. To date, the Alliance has found it easiest to find and partner with debt investors. The goal for enterprises servicing debt at below market rates proves creditworthiness and attracts market rate capital as the ventures scale and grow. As the enterprise grows and becomes more mature, it becomes increasingly attractive to equity investors and impact investing funds that invest mainly through convertible debt and equity instruments.[1]

1 Kohler, Kreiner, and Sawhney, "Coordinating Impact Capital".

The table below details how a mix of funds can play a role in supporting enterprises.[2]

Start-up	Venture	Growth	Mature
Equity • Founder • Friends/Family/ Fools • Partners **Debt** • Personal loans • Credit cards **Other** • Grants	**Equity** • Founder • Friends/Family/ Fools • Angel or seed • Partners **Debt** • Personal loans • Bank lines of credit • Development finance institutions **Other** • Grants	**Equity** • Impact Investors • Large corporations interested in merger or acquisition **Debt** • Bank loans • Development finance institutions • Impact investors (funds, individuals, etc.) • Government or other guarantees **Other** • Grants	**Equity** • Impact Investors • Partners • Large corporations interested in merger or acquisition **Debt** • Bank loans • Development finance institutions • Impact investors (funds, individuals, etc.)

The following case study shows how an enterprise can progress through the life-cycle financing stages as shown in the table above. The study gives the example of Greenway Appliances as they moved from solely grant funding to acquiring debt financing in the form of bank loans, and are now looking at equity financing. This progression can be seen in conjunction with the progression made through the different growth stages of an enterprise.

German Sandoval for the Global Alliance for Clean Cookstoves

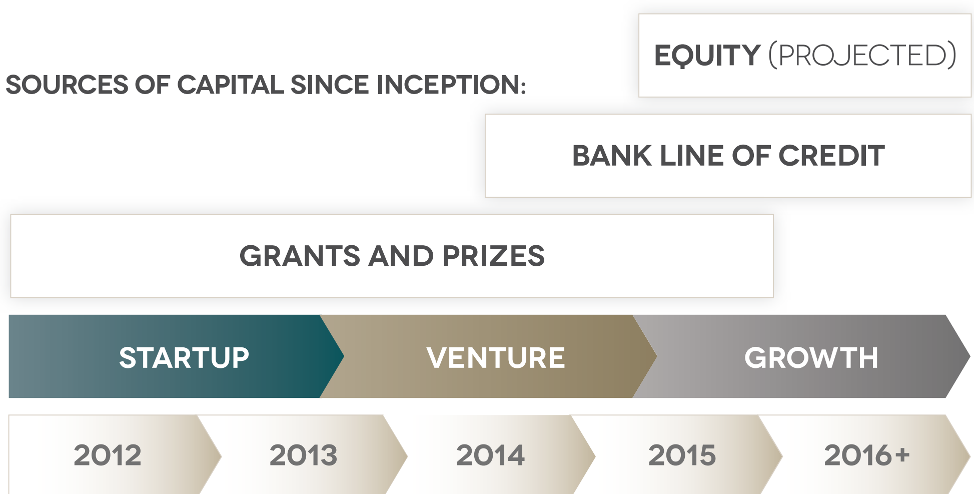
2 Adapted for clean cooking sector companies based on presentation by John Kohler at the ANDE Investment Manager training in June 2014 in Mexico City.

2.3 REALITY CHECK: Greenway Appliances Case

Greenway Appliances, formerly Greenway Grameen Infra, has sought out capital from multiple sources as their company has matured and their capital needs changed. When entrepreneurs Neha Juneja and Ankit Mathur first became Alliance partners in 2012, they were leading a company that was still very much in start-up mode. They used their own funds and sought out prizes and grants to get the company going. Once they had developed a quality product and early partnerships with distributors, having achieved sales of 18,000 units, Greenway applied for the Alliance's Pilot Innovation Fund grant in 2013.

Greenway

After implementing a series of above the line marketing experiments and conducting a brand awareness analysis using the Pilot Innovation Fund, Greenway integrated the lessons they learned from the brand awareness analysis and applied for a Spark Fund grant in the fall of 2013 to scale up their operations. By then they had sold 60,000 units, activated 41 retail outlet partners, and were ready to diversify their product offering. Greenway submitted their business plan and following a due diligence process, the Alliance awarded them a Spark grant to implement their revised marketing strategy, diversify their product portfolio, expand their reach to southern India, and strengthen their management team by adding marketing, management information systems (MIS), and human resources managers.



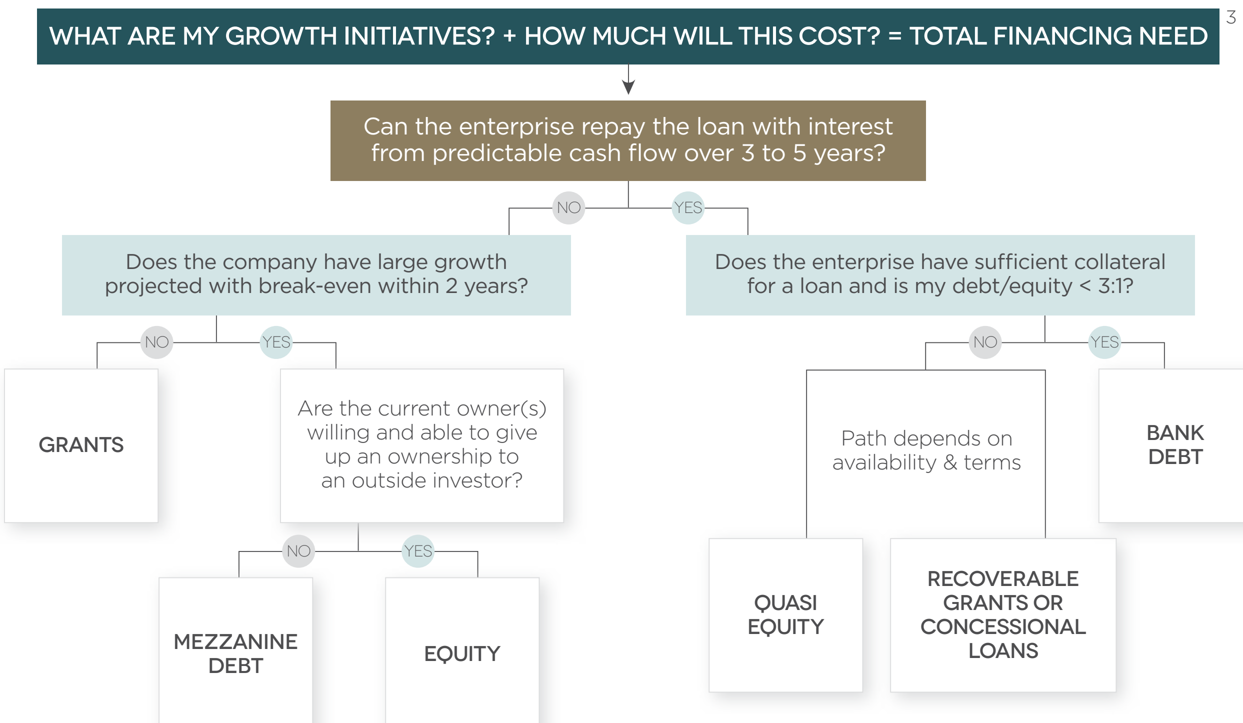
The Spark Fund has allowed Greenway to grow their customer base and launch new products, however, their increase in sales resulted in a working capital need best filled by debt financing rather than grants. In 2014, they sought outside consulting to improve their accounting processes and conduct audits, and they hired a CFO. Soon after, they secured a line of credit of 5 million rupees, or about 80,000 USD from their local bank to help them purchase raw materials to produce enough product to keep up with demand. Greenway plans to seek an initial round of equity investment in 2015 based on current growth plans and has already been talking to potential equity investors.

2.4 TOOL: A Decision Tree to Financing

As demonstrated by the Greenway case, enterprises often need a mix of capital as they grow. After assessing an enterprise's stage of growth, amount of, and the uses of capital through the due diligence process, the appropriate finance instrument can be determined. Enterprises and enterprise supporters can use the following chart and questions to determine which financing instrument to seek out. The decision process is detailed in the table below.

Uses of Financing Structure Table and Chart:

- Use guiding questions to assist in understanding what type of financing is most appropriate for an enterprise
- Better understand the different financing instruments and their implications for a social enterprise



The tool is a simplified way to look at the potential risk, yield, and upside of the investment. Risk is a function of the variability of expected returns and the time frame expected for making such returns. The higher the risk of the project, the higher the return you would require as an investor. Yield is any payment made to the investor during the period for which the investment is outstanding, other than payments which reduce capital. Social enterprises, especially clean cooking companies, are often not able to service high interest rates (yields) for debt financing, and they will often take a longer time to provide an upside for equity—typically more than five to seven years.[4] Upside arises from selling a security for a higher amount than was originally invested in it—capital gain for example. Upside arises from: sale to another investor or the redemption at a premium in cash or securities of the investee companies in the securities of another company or asset.[5]

3 Achleitner and others, "Social Investment Manual".
4 Kohler, Kreiner, and Sawhney, "Coordinating Impact Capital".
5 Achleitner and others, "Social Investment Manual".

2.5 Idea in Brief

Securing appropriate type(s) and level of financing is essential for clean cooking enterprises to grow and build capacity. Different types of financing instruments exist, and different growth stages require different combinations of funding options. It is therefore important to consider all financing types available to deploy, in order to grow enterprises in the sector. An examination of funding needs through a survey of individual enterprises can be aggregated at a macro level to help mobilize capital to the sector.

Whether seeking funding by way of grants, debt, equity, or any such combination, all variety of enterprises can find a way to receive the financial support needed to see their enterprise grow and thrive. Making sense of the right financing option for an enterprise can seem daunting, however the information presented in this section will foster understanding of each financing instrument and guide the decision making process.

Chloe Shields

3

HITTING THE ROAD:

HOW TO DEVELOP AND IMPLEMENT FINANCING MECHANISMS FOR ENTERPRISES

We begin this section by assuming that you have located where the enterprises in your market are starting and that they are likely start-up, venture, and growth stage organizations. Since the Alliance is a public-private partnership, we have chosen grants and partnerships with debt and equity investors to meet the financing needs of enterprises on their journey to scale. We provide an overview of the use of grants, help you replicate the steps the Alliance took, and share the tools developed to support enterprises. We then discuss how to partner with debt and equity investors, by first understanding the pipeline of funding needs, to seek out the right partners and then align interests in impact.

What you'll learn in this section:

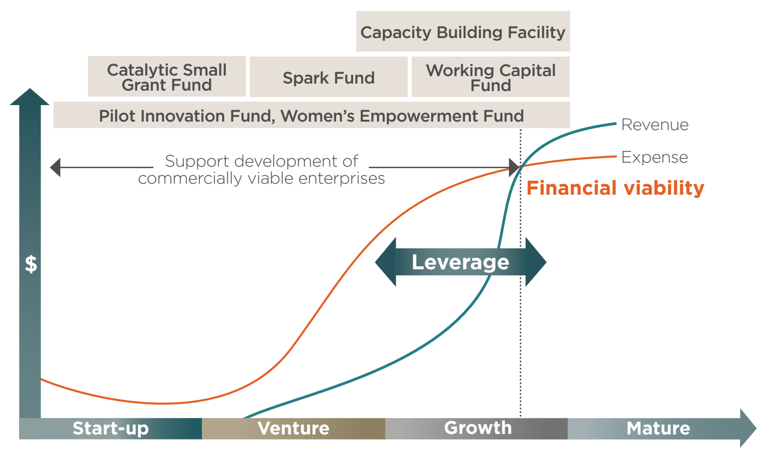
- How to design and implement grant funds that effectively lead to follow on investment
- How to conduct due diligence to select enterprises to support
- How to partner to mobilize investment

3.1 Grants as Tool of Enterprise Development

While decades of cookstove implementation experience and hundreds of organizations active in the sector are a strong foundation to build on, the clean cookstoves and fuels market is relatively under-developed and highly fragmented. Few impact investors are prepared to provide money and technical assistance to early stage companies. Furthermore, traditional sources of capital are out of reach for early stage or smaller entrepreneurs who operate in unproven markets and have yet to achieve commercial viability at scale. Grant investments are needed to reduce the risk to investors and bridge the pioneer gap—the dearth of impact investors willing to invest in early stage businesses, preferring instead to invest once commercial viability has been established. Grant investments also serve to raise the profile of the sector and allow entrepreneurs to leverage the capital for further investment.

The Alliance launched its grant programs in 2012 with the aim of catalyzing the growth of clean cooking companies and preparing them to seek follow on investment. The Alliance started with two grant funds, the Spark Fund to bridge the gap from startup to scale and the Pilot Innovation Fund to spur new innovations in the sector. These funds have continued to evolve to better provide a seamless link between grant funding and impact investing, and additional funds were added to support the local enterprises based in Alliance focus countries, and to support women's empowerment initiatives.

The diagram shows the suite of financial products the Alliance has designed to enable enterprises at different stages of development to grow and leverage further investment, complementing a larger strategy to build and support a pipeline of investment ready companies. The grants provide capital at these stages, and the Alliance applies an investment rigor to the selection and management of the grants, preparing them for the demands of an equity or debt investor.[6] The structure and management of the grants are optimized to help enterprises attract the follow on investment needed to grow the sector and achieve our collective goal of 100 million households adopting clean cooking technologies by 2020.



Note: The Clean Cooking Working Capital fund is a concessional loan fund, not a grant fund.

THE SPARK FUND

The Spark Fund is a grant facility designed to mirror early stage investment. It aims to invest 2 million USD in grant capital annually in enterprises with scalable approaches that have the potential to transform the sector through their success. Spark grants target the specific capital and capacity development needs of enterprises across the value chain that have passed the start-up stage.

Highlights of the grant structure:

- Spark venture grants from 100,000 to 300,000 USD and Spark growth grants from 300,000 to 500,000 USD.
- Grant capital funds growth initiatives as outlined in the enterprise's business plan.
- Due diligence is conducted on each grantee before making an investment, which includes a site visit and gender lens due diligence.
- A panel of venture philanthropists and investors review business plans and due diligence analyses. The grant amount is decided based on how much capital each company can reasonably deploy in one year and the capacity development needs of each company.
- Funds are disbursed in tranches based on companies meeting performance and capacity milestones.
- Grantees must report quarterly on social and operational metrics and provide financial statements.

6 Kohler, Kreiner, and Sawhney, "Coordinating Impact Capital".

3.2 Idea in Practice: How to Fuel Enterprises Using Grant Funds

As discussed in section two, grants may be the only option at the start up, venture, and growth stages, depending on the enterprise and growth stage. This section is for enterprise development organizations that have the resources or mandate to disburse grants to strengthen the supply of the clean cooking sector. When designing and implementing grant funds, the Alliance focuses on strength in three key areas: fund design, enterprise selection, and fund management. When establishing a grant fund like Spark, the following six steps should be taken:

1 Determine the size and number of grant needs by conducting a growth stage analysis, highlighted in section one. Determine what growth stages your fund will target.

2 When sourcing the companies, it is up to each individual organization if it can handle a rolling process to accept business plans or if it needs to set a specific window of time through an open, competitive process. Due to the nature of the Alliance's funding stream and capacity, we work with a Request for Proposals (RFP) process that opens once per year. Past Alliance RFPs for the Spark Fund can be found at the Global Alliance for Clean Cookstoves website.

3 The Alliance then narrows down applications using the following process selection criteria. In addition to good governance and Alliance mission alignment, here are some examples of what the Alliance looks for when evaluating potential clean cooking investments:

- **Product viability and acceptance in target market:** There is no "one size fits all" clean cooking solution, and the Alliance looks for companies that have designed their product with potential customers and users in mind. The due diligence process includes interviews with customers, rating their satisfaction with the product and the enterprise overall.
- **Ability to scale:** The Alliance has an ambitious goal of reaching 100 million households by 2020. This means that we need a number of strong stove and fuel supply partners that are able to achieve economies of scale and meet the varied needs of the 500 million households that cook with solid fuels and inefficient stoves. The Alliance looks at the market, the business model, strength of key partnerships, and the financials to determine ability to scale.
- **Financial viability in the long term:** The Alliance is not able to make enough grants to fill the capital needs of the global clean cooking sector. Thus, Alliance grantees are expected to graduate from grant support and seek out capital in commercial markets. This means that the enterprises need to demonstrate to the Alliance that they have a long term plan to reach profitability or sustainability. The goal is to support a high potential enterprise, not subsidize an unsustainable model.

TECHNOLOGY PERFORMANCE

It is important to note here that an assessment of the performance of clean cooking technologies needs to be done in addition to the enterprise analyses described in this document. The Alliance encourages, and in some cases requires, that enterprises submit testing results according to the International Workshop Agreement (IWA) format in order to apply for Alliance grant opportunities, and furthermore encourages enterprises to submit their technologies to the online clean cooking catalog: http://catalog.cleancookstoves.org/.

IWAs are a streamlined ISO consensus process that can be a first step towards formal ISO standards. Approved in February 2012, the cookstoves IWA provides a framework for rating cookstoves on four indicators, each along five tiers. More information on the IWA can be found here: http://www.cleancookstoves.org/our-work/standards-and-testing/guidelines-and-standards/guidelines--standards-documents/iso-iwa-final.pdf.

GENDER BEST PRACTICES

The Alliance also looks for gender best practices within its business model and operations when selecting enterprises. The gender due diligence process (discussed in section 3.4) aids the Alliance in determining if there is a gender mission fit and if the business is maximizing opportunities to implement gender-informed practices before selecting the enterprise for funding. Gender best practices are outlined in the Alliance's *Resource Guide on Scaling Adoption of Clean Cooking Solutions through Women's Empowerment* [http://www.cleancookstoves.org/our-work/gender-guide.html].

Here are some examples of what the Alliance looks for in effective, gender-informed business models:

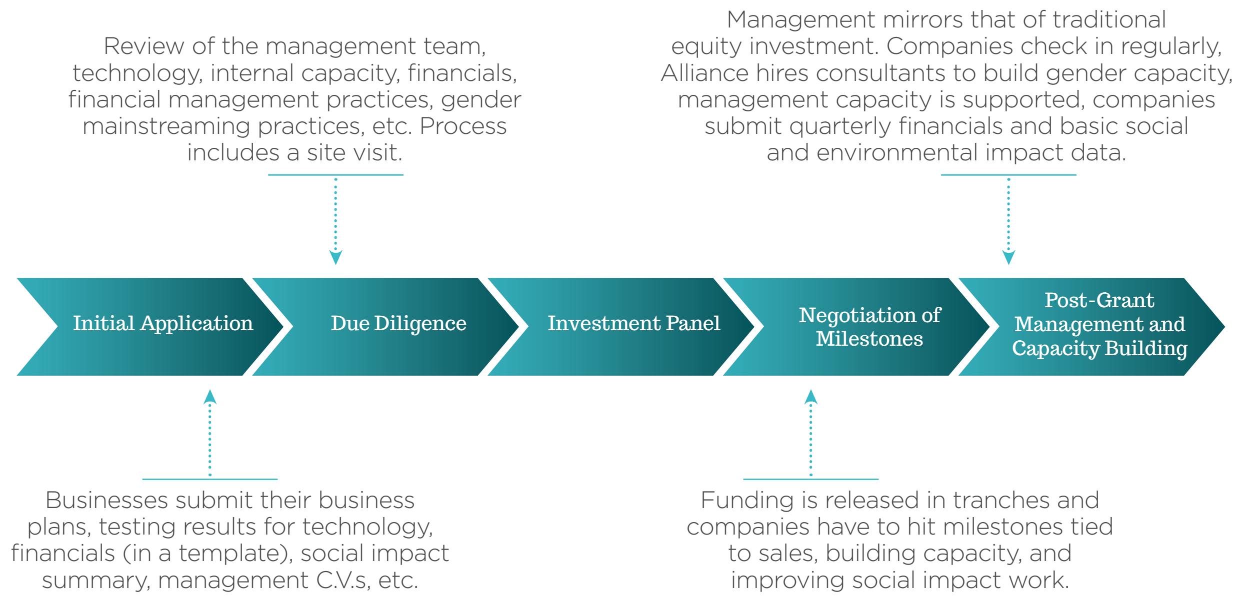
- All data is sex-disaggregated.
- Financing options are accessible to both women and men consumers.
- Focus group discussions with women and men are conducted to inform product design marketing and distribution strategies.
- Impact methodologies and indicators measure household-level impacts on time, health, decision-making power, etc.
- The business plan includes a gendered value chain assessment, which looks at the gender components of stakeholders and operations across the entire value chain.
- The enterprise works with women entrepreneurs as distributors and has a gender-informed recruitment, training, and retention plan.

Once the enterprises are narrowed down based on the above criteria, the Alliance selects the top enterprises to undergo due diligence (see due diligence process tool in this section).

4 Identify strategic partners that could provide follow on funding. These investors are included in the grantee selection process, which educates them on the businesses and the potential in the sector, with the potential to engage their interest to be a follow on investor. Additionally, they provide input on the key milestones that the enterprises need to meet during the grant period in order to receive follow on investor funding.

5 Design the grant management process. If the grant is structured to mirror early stage investment, it needs to be managed that way. This means agreeing on milestones related to growth of the enterprise (typically sales in units) and related to achieving and completing the growth strategy. The funds are disbursed in three to four tranches once milestones are achieved. Grantees have monthly calls with Alliance staff to talk about progress. These calls are used to alert the Alliance of potentially missing milestones. The Alliance also uses these check-ins as an opportunity to connect grantees with mentors, potential partners, and other resources as the enterprise faces new challenges in implementing its growth plans.

6 Set reporting requirements. We recommend quarterly submission of financial statements as well as quarterly reporting on operational and social indicators. The Alliance provides the reporting template that tracks indicators across the fund grantees and individualized goals of each grantee



The diagram above provides an overview of the Spark grant process. By the end of each grant, the grantee should have audited financial statements, technologies that have been tested in independent laboratories, and the capacity to provide financial information at least quarterly. Additionally, the Alliance encourages each grantee to understand the strengths and weakness of the business from a gender perspective and likely has a gender action plan by the end of the grant period. Most should have built out their senior management teams, increased production capacity, and have new management information systems as a result of the grant funding.

Monitoring and evaluation of financing mechanisms is critical to ensure that programs are helping to grow businesses in the sector. The key performance indicators for the Spark Fund are:

- Investment dollars leveraged by grantees after receiving the grant
- Growth in the enterprises, measured through employment and revenue growth

Even the strongest plans to build a pipeline of strong enterprises through a grant like the Spark Fund can miss the target. Through two iterations of the Spark Fund, the Alliance realized that a new grant fund needed to be developed to better target and support grassroots enterprises. As a result, the Alliance developed the Catalytic Small Grants program. The Ghanaian version of this program is discussed in the case on the next page.

Dalberg

3.3 REALITY CHECK: Ghana Catalytic Small Grants

After the first round of the Spark Fund, the Alliance realized that there was a subset of businesses in its focus countries that were not being reached by Spark. We realized there was a need for country-specific mechanisms that fund capacity building and growth of start-up and venture stage companies. We piloted this program in Ghana since it has an active private sector that has an established track record in the market; however, the companies have remained smaller and production is still mainly artisanal in nature. During the Spark selection process the panel of impact investors noted a lack of unique selling propositions amongst the businesses in Ghana, since the products are relatively uniform and sold into the similar markets. Furthermore, the artisanal nature of the production of the common stove model not only caused bottlenecks for the scale up of the enterprises, it also created an inefficient cost structure for the enterprises.

In order to address these specific market dynamics, the Alliance began to look at a smaller fund tailored to the specific needs of the Ghanaian companies. After selecting and conducting due diligence on eight companies in the country, the Alliance decided to create the Catalytic Small Grants fund for Ghana. This fund is very similar to the Spark Fund, but supports the enterprises that do not yet qualify for the fund and are usually locally owned and operated. Their grants focus on improving their operations and implementing one or two growth initiatives to better position themselves for future support. The three components to the Catalytic Small Grants program are:

1. **Investment readiness analysis** is conducted on strategically placed enterprises in the clean cooking sector in each focus country, which identifies key capacity development and growth initiatives to catalyze the sector. The analysis involves two- to three-day site visits to assess all aspects of each enterprise selected, including meeting with suppliers, distributors, and end consumers, as well as with the management team to review their operations, growth plans, sales and marketing strategies, and financial positions.
2. **Small grants** to selected companies from the investment readiness analysis to fund catalytic enterprise development and growth initiatives that will increase likelihood of investment, enrich the value chain through more efficient production and enhanced distribution, and foster strategic partnerships to strengthen the sector.
3. **Capacity building funding** supplements the small grants to assist companies with maximizing the use of grant funds, and develop grantees into strong, scalable companies.

Arijit Basu, Global Alliance for Clean Cookstoves

3.4 TOOL: Due Diligence Process

The Alliance, as a donor and investor in the sector, conducts due diligence before making a final funding decision. Due diligence is a powerful tool in a grant program that has the goal of an enterprise scaling and graduating to traditional capital. The Alliance has designed a due diligence process that focuses on three key areas: governance and alignment with the Alliance's mission (including best practices in gender mainstreaming), organization viability in the long term (including consumer satisfaction with product), and determining the organization's capacity development needs. The inputs to the due diligence are the information in the grant application, desk-based data gathering, such as reference checks, and a site visit of one to two days to verify what was discovered during the desk analysis. The process is outlined in the diagram below.

DESK DUE DILIGENCE

- Application documents
- Additional documentation requested
- Review of legal incorporation and tax documentation if possible
- Basic understanding of company's management, operations, sales & marketing, finances, etc.

SITE VISIT

- Consultants arrive with pre-filled due diligence document
- Additional questions are asked. Interviews are conducted with management, customers, suppliers, and distributors if possible
- Financial projections are verified

CREATION OF DD REPORTS

- Consultants finalize information
- Any additional information is collected
- A SWOT analysis is created for each company
- A basic company overview is created outlining appropriate growth funding needs and capacity needs

The Alliance has made its due diligence Excel template, developed by I-Dev International, available online as a part of this toolkit. This template covers an overview of the company history and structure, including management analysis, an operational overview with an analysis of accounting and systems processes, and an analysis of the sales and marketing strategy (including interviews with current customers). The review continues with an analysis of the strength of the financial statements, a description of current funders, funding requests and growth funding needs, a gender lens analysis, and a desk review of the sustainability of scaling up fuel production/distribution at scale (only used in the case of fuels companies).

The link to the extensive due diligence template can be found here: http://www.cleancookstoves.org/resources_files/due-diligence-template.xlsx.

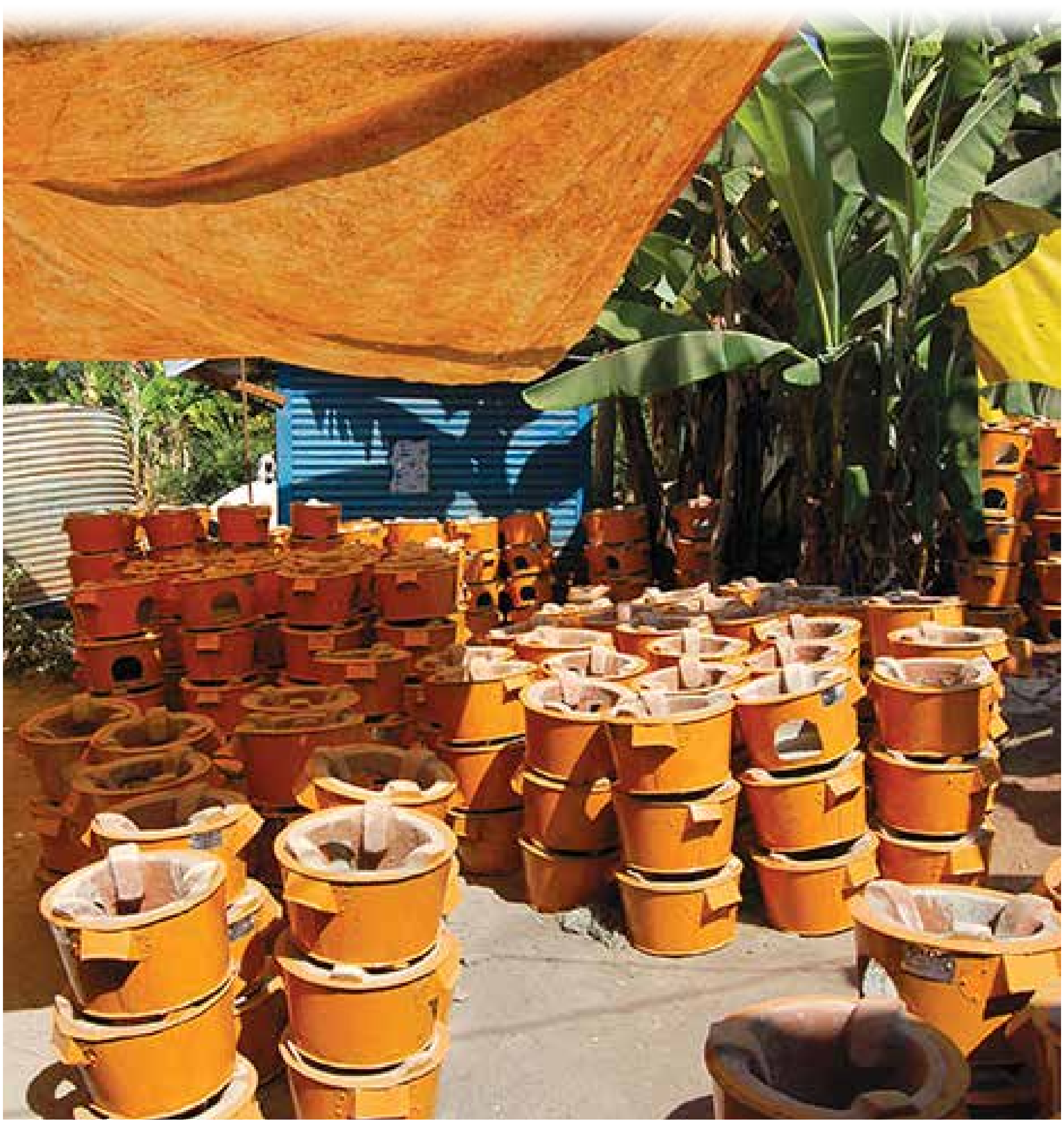
In addition to reviewing the enterprise financials and operations, Alliance complements its due diligence process with gender lens due diligence to evaluate applicants for its Spark Fund, in order to understand the gendered barriers and opportunities of the enterprise. The Alliance commissioned the firm, Value For Women, to develop a gender due diligence tool in order to understand and recommend gender considerations for cooking sector business models. Conducting gender due diligence allows you to identify strengths and weaknesses in four key areas: marketing, product and operational impacts, inclusion of women in the value chain, and internal policies and procedures. It provides a framework for analyzing whether enterprises have incorporated gender best practices into their business plans and operations. For example, marketing strategies must be gender-informed in order to understand the gender dynamics and norms amongst targeted consumer segments. Gender norms related to women's mobility, available time, access to skills and information, and decision-making power, can all impact the likelihood of purchase and use of clean cooking solutions among both women and men.

Once the due diligence process is designed and the desk research is conducted, the Alliance prepares for site visits. This, of course, requires planning on the part of the individual or firm conducting the due diligence, but the Alliance has learned that it is just as important to prepare the enterprise for the process. This can be done with the tools below, and the person or team conducting the due diligence should notify the enterprise, in advance of the visit, the nature of information the enterprise will be expected to provide, as well as specific sites or processes the team will want to see. In the case of the Alliance's analysis process, the analysis template is even shared with the enterprises in advance of the site visit.

In order to better prepare enterprises in the sector for the Alliance's due diligence process and later other investment opportunities, the Alliance prepared a simple document checklist and a more in-depth assessment tool. The assessment tool is intended to track how the company is progressing in the development of the documents and processes an equity investor would see. The document is based on equity investment since it usually involves more diligence, due to the riskier nature of investments. You can find the links to the investment readiness assessment here: http://www.cleancookstoves.org/resources_files/assessment-tool-investment-readiness.xlsx.

A list of documents and information that most investors will look for during their due diligence process can be found here: http://www.cleancookstoves.org/resources_files/investment-readiness-checklist.pdf. Note: Each investor has developed a unique due diligence process and may ask for documents and information not related to this list.

Once the enterprises are prepared to submit their materials and host site visits, the Alliance's due diligence process continues with a site visit and creation of due diligence reports. Even when the Alliance prepares the enterprises for the due diligence process, they are typically not prepared with all of the materials required, nor do they perform highly in all operational areas evaluated. This does not usually eliminate an enterprise from potentially receiving support from the Alliance. While due diligence is typically seen as a gateway to make a funding decision for an enterprise as part of a grant or investment program, the Alliance has used this as a capacity building opportunity. We use the gaps in preparedness and performance discovered during the due diligence process to improve allocation of funds towards the enterprises growth initiatives and towards capacity building. An example of using due diligence to reallocate proposed budgets and growth initiatives is provided in the Eco Fuel Africa case study in this section.



Chloe Shields

3.5 REALITY CHECK: Eco Fuel Africa Analysis Findings

ECO-FUEL AFRICA LIMITED
Environmentally Friendly Charcoal

Eco Fuel Africa (EFA), an agricultural waste to char-briquette company based out of Uganda is a Spark Fund grantee. They had been operating for three years and had received a small angel investment, as well as grants from National Geographic, USAID's Development Innovation Ventures program, and DFID. EFA's CEO Sanga Moses Black decided to apply for funding at the growth stage after positive feedback from previous donors. His company had 20 employees and revenue growth of 180% during the previous year. The in-depth analysis revealed a quality company with high potential for impact. However, EFA needed to work on internal capacity issues before receiving funding at the growth stage. In addition, EFA had received a number of other grants for growth initiatives, and historically, their revenue was not high enough to justify a 500,000 USD grant to be spent within a year. The Alliance ultimately decided to fund EFA, but at the venture stage, and with funds directed to an overhaul of financial systems and inventory tracking systems, along with increasing production capacity.

Eco Fuel Africa

3.6 Idea in Practice: Finding the Right Investor to Split the Petrol Bill

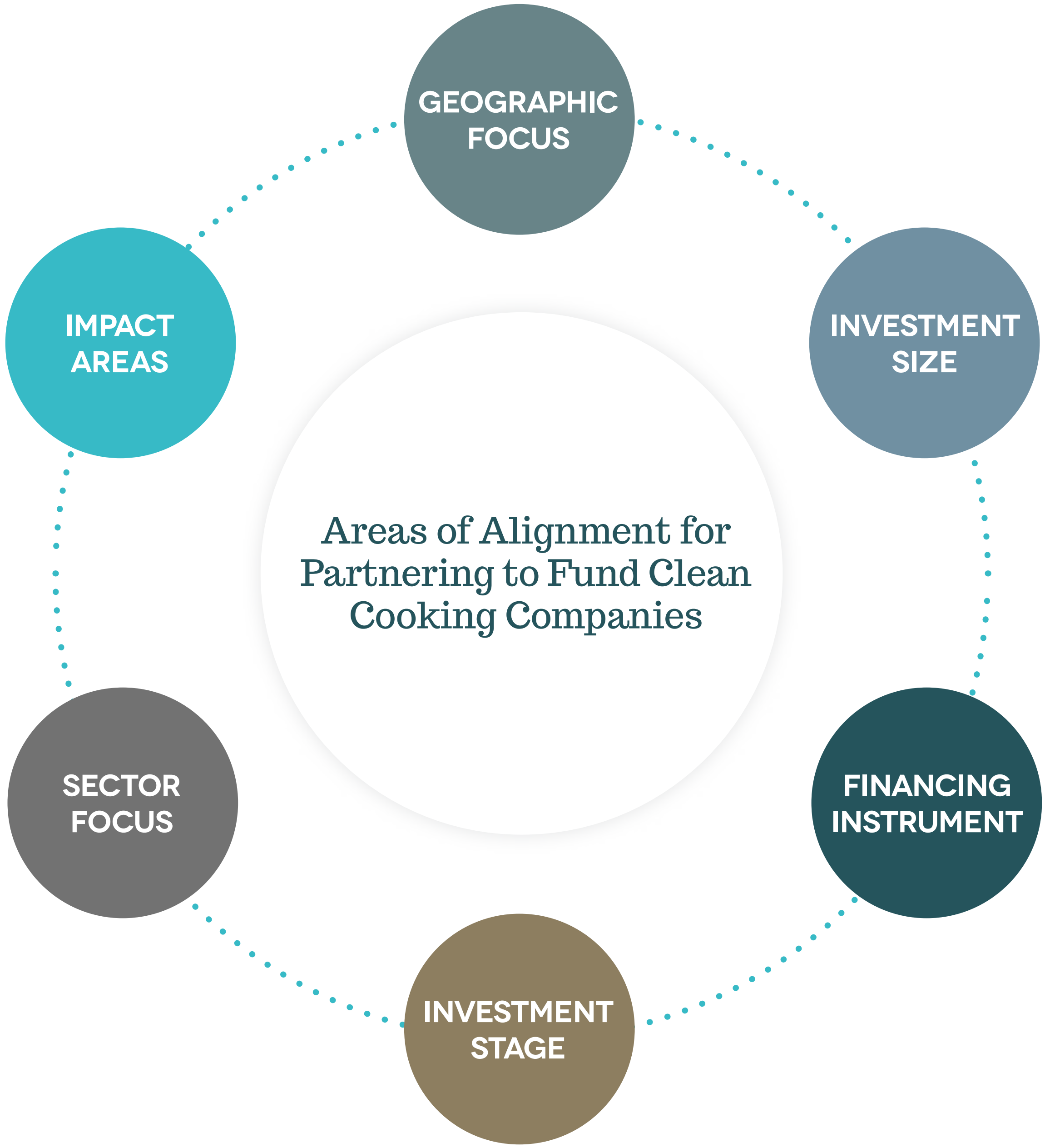
While the first part of this section was heavily focused on grants as a financing mechanism for enterprises, the Alliance has seen potential for more commercial capital to enter the sector through partnerships. Given that grant capital is not recovered and re-granted, grants can seem like an expensive way to support clean cooking enterprises on the path to scale, but as highlighted in sections one and two, they are oftentimes the type of capital early stage enterprises need. The Alliance has found grants particularly useful and necessary in the clean cooking sector, provided that they are managed in a way that enterprises can graduate from them as they develop the capacity to access debt and equity investment capital. Ideally, investors should be readily available to support enterprises that have recently graduated from grant support. However, there is still a gap in the sector, in terms of long-term risk capital, which is critical for individual company growth and overall sector scaling. Without such long-term capital, the sector will struggle to scale up, and the Alliance could fall well short of its goal of 100 million households adopting cleaner and more efficient cooking solutions by 2020. To that end, the Alliance partners with investors to share the petrol bill on the road trip to scale, so to speak.

The Alliance recommends going into conversations with potential financing partners with a pipeline analysis in hand. The analysis helps determine who to talk to (debt funders, donors, equity funders, etc.) and what level of financing will be needed. This information can be obtained through a survey where enterprises provide information on their financing needs, including amount, for what purpose, and what type desired—debt or investment—and the financial picture of the company, including balance sheet and income statement information. The latter is important in order to test the suitability of the type of financing a company thinks it needs. For example, if a company indicates it needs debt, but its balance sheet is already largely comprised of debt and it has yet to turn a profit, equity financing might be more suitable than debt financing. In general, if a company has a debt-to-worth ratio of 1.5 to 1 and does not expect to breakeven within a year, it is very unlikely it would be able to obtain any additional debt financing. Of course, there can be offsetting aspects of a company, including having a high level of collateral to pledge, or having a one-off year of losses that is expected to be short-lived.

As opposed to a survey, this information can also be gathered through aggregating the results of a current, in-depth analysis of a sample of enterprises, which has been drafted using the financing decision tree model highlighted in section two. The Alliance recommends determining what the financing needs of the sector are in terms of debt and equity in order to best understand if it should be engaging principally with banks (debt providers) or investment funds (equity providers), in mobilizing capital into the sector. An example of finding financing partners to help fill the financing gaps of the sector will be discussed in more depth later in this section.

Dalberg

When identifying partners for enterprise development, it is also important to ensure there is a good fit in terms of values and mission. This can be determined during the initial meeting with a potential donor or investor. These are some of the areas to consider when approaching a partner to fund an individual enterprise or the scale up of the sector in the market.



A note here on impact areas: clean cooking solutions have the potential to achieve health, environmental, women's empowerment, and livelihoods impacts; yet, the degree of these impacts vary depending on the technology and frequency of use. A syndicate of donors, investors, and capacity development organizations should have an open conversation on the desired impacts of a fund based on their missions.

While partnership is strongly encouraged to avoid under-funding an enterprise at a time of growth, even the act of building the pipeline of viable companies and educating funders about the sector helps attract financing. For example, the Alliance's work to build a pipeline of enterprises has also resulted in a partnership with Deutsche Bank to provide working capital to the sector.

3.7 REALITY CHECK: Deutsche Bank Clean Cooking Working Capital Fund

Working capital is a key area of funding need for many clean cookstoves and fuels businesses. To address the challenge of limited access to working capital, the Alliance has partnered with Deutsche Bank's Global Social Finance Group to structure a 4 million USD not-for-profit revolving Clean Cooking Working Capital Fund. The fund deploys working capital loans and loan guarantees to enterprises that are not able to access more traditional forms of debt financing. This fund will make available three to five year flexible financing of up to 400,000 USD at a concessional, yet sustainable, interest rate to cover the ongoing operating costs and credit losses of the fund.

Deutsche Bank learned more about the needs of the clean cooking sector through participating on the Spark Fund panel and realized that there was a huge potential for social and environmental benefits. Deutsche Bank's Global Social Finance Group's expertise is offering financing solutions to enterprises that provide essential services to disadvantaged communities globally. Since 1997, the Group has structured ten debt funds, which have supported the growth of more than 100 microfinance institutions and social enterprises located in 50 countries around the world. The 330 million USD these funds have invested have benefited millions of low-income households through greater access to financial services, affordable housing, healthcare, education, and other basic services.

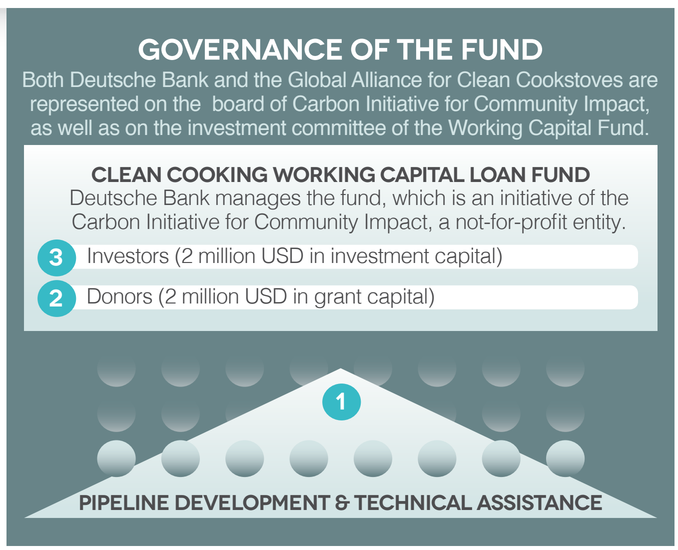
General Features

Capacity Building Support

1. Alliance provides grant capital and capacity building to clean cookstove and fuels firms to support their:
   - Investment readiness pre-investment and
   - Sustainable growth post-investment.

Capitalization of the Fund

2. Alliance leads the fundraising effort for the grant capital in the fund.
3. Deutsche Bank leads the fund raising effort for the investment capital in the fund.



3.8 Idea in Brief

The road trip to scale requires a mix of funding mechanisms. The Alliance has developed grant programs and partnered with investors to help enterprises reach their destinations. Grants need to be structured and managed in a way that helps enterprises graduate into commercial capital. A crucial piece of the structure of the Alliance's grant programs is the due diligence process that identifies mission fit, growth initiatives, and capacity needs. Once enterprises are able to seek out investment to scale, commercial capital needs to be waiting to provide the follow on capital. The Alliance has worked with financing partners to be the co-pilot on the journey and recommends partnering with investors to ease the transition.

4

SERVICING THE ENGINE:

HOW TO DEVELOP A CAPACITY BUILDING SUPPORT STRATEGY

Enterprises need more than access to finance to develop and grow their businesses. Capacity building can range from help with strategic planning to implementing systems and processes needed for good governance of a company.

This section first describes how capacity building needs are related to the growth stages of the company and discusses the importance of developing tailored support for enterprises. The section then provides tools to develop a capacity building strategy to complement the financing strategy for enterprises. Finally, it discusses the importance of partnerships to support the capacity development strategy.

What you'll learn in this section:

- How capacity building is coupled with enterprise finance to support enterprises as they grow
- How to use a pipeline approach to creating a capacity development strategy
- How to use a capacity questionnaire and in-depth analysis

4.1 · · Capacity Building Through the Growth Stages

Lack of internal capacity within clean cooking enterprises remains a key challenge to ensuring investor confidence and mobilizing sufficient capital, and few impact investors are prepared to provide the capacity building needed to strengthen these businesses. This is an area where organizations like the Alliance can add value. The Alliance has found that business capacity needs of enterprises in the clean cooking sector are very similar to social enterprises in other sectors. There are a few areas of unique challenges and opportunities for enterprises in the clean cooking sector that donors and investors should consider supporting. An overview of areas of support in capacity building is outlined in the following table:

GENERAL BUSINESS NEEDS	SPECIFIC NEEDS TO SECTOR COMPANIES
➤ Financial management ➤ Strategic planning ➤ Marketing and awareness ➤ Sales and distribution ➤ Operations & MIS ➤ Human Resources & recruiting ➤ Financial model & pitch deck	➤ Implementing gender best practices ➤ Improve technology performance and design ➤ Stove and/or fuel performance testing ➤ After sales and service ➤ Measurement and reporting of social and environmental impacts

When designing capacity development support programs to complement an investment strategy in the sector, the nature of the program depends on the financial resources and time you are able to dedicate towards building a sector. This will determine whether your organization takes an approach of supporting a discrete number of enterprises in the market, perhaps through a value chain approach, or whether it should take a long-term, pipeline-building view. The size of the market may also factor into this decision. For example, it may make sense for smaller markets with fewer of players to focus on a discrete number of enterprises, while a larger market with a number of players could be supported in a pipeline approach. The Alliance, as a global organization, has taken a long-term pipeline approach to supporting enterprises, which will be discussed in depth in this section. A mapping of the enterprises through a growth stage or similar assessment, as outlined in the first section, can inform which approach would work best for a given market. The tool below can be added to the growth stage assessment to further build out an understanding of the capacity development needs of the sector within a specific regional market.

Sustainable Green Fuel Enterprise

4.2

TOOL: Capacity Development Questionnaire

The capacity development questionnaire is a simple set of questions that can be added to the growth stage assessment to gain an understanding of gaps across areas such as human resources, financial management and strategy. You can find the questionnaire at this link: http://www.cleancookstoves.org/resources_files/capacity-building-questionnaire.pdf.

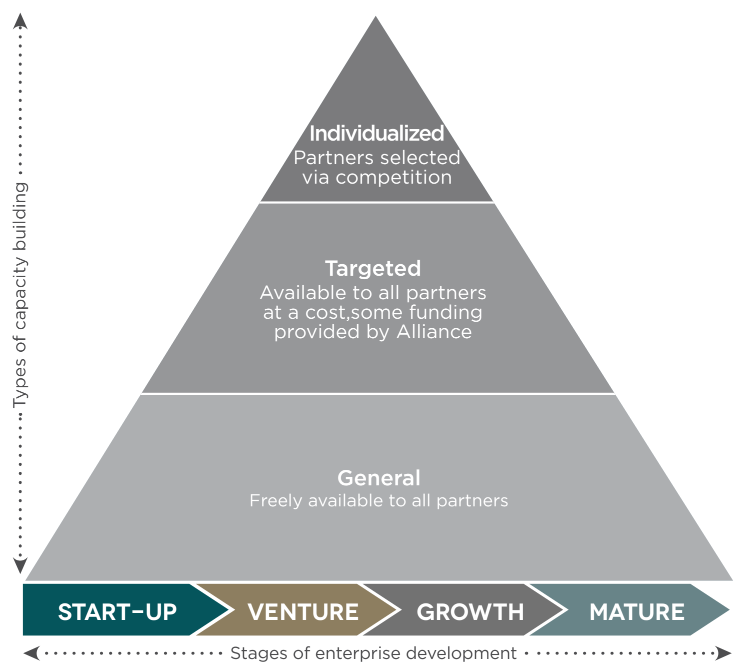
Chloe Shields

4.3 Idea in Practice: How to Build a Capacity Development Strategy

After conducting the growth stage assessment and learning more about the capacity development needs of specific organizations, you've hopefully made a decision on whether to provide support to a discrete number of enterprises or work on building a long-term pipeline of companies to support. This section gives an overview of what each strategy looks like.

In the case of an organization that will only support a discrete number or organizations, the Alliance would recommend conducting an in-depth company analysis to determine the enterprise's capacity gaps and develop recommendations based on the growth plan of the enterprise. This can be done by first having an enterprise fill out a growth stage and capacity development questionnaire, complemented by an in-depth analysis, as outlined in the first section of this document. In some cases, the donor or investor may not be able to service all of the needs outlined by the assessment and should find partners and experts to fill the gaps.

A pipeline approach takes time to develop and implement, but it can be a great way to allocate resources to enterprises with the end goal of supporting each enterprise's individual needs and building up the next group of companies that can receive tailored support. The Alliance does this through three types of capacity development programs: general programs for a wide audience at a lower cost per enterprise supported, targeted programs for a specific market or capacity need at a slightly higher cost per enterprise supported, and individualized support that works on one or two key areas that need to be addressed in order to make it to the next stage of growth and attract financing. General programming ranges from webinars and online materials available to all Alliance partners, to support of entrepreneurs to attend the GSBI Social Enterprise Boost program (discussed later in this section), which helps local entrepreneurs with basic business planning skills. Targeted programming may include a subject matter workshop in a particular area such as marketing, human resources, gender capacity building, stove testing and design, etc. Finally, individualized programming is usually reserved for enterprises that are already receiving funding support from the Alliance or an investment partner and involves engaging experts in the subject area where the enterprise receives support. Just as enterprises graduate through levels of funding at the Alliance, they will graduate out of certain generalized and targeted support programs. The graphic to the right gives a picture of how the capacity building support strategy of the Alliance is structured:



The Alliance has a 1,000-member-strong partner base that is ready to receive support and strengthen the pipeline of enterprises with the potential to scale. We provide examples of all three types of support that the Alliance offers in this section:

- **General Support:** Look for the GSBI case study that describes the Social Enterprise Boost program.
- **Targeted Support:** Look for case study on Latin American enterprises that received support through workshops developed by the Alliance and I-Dev International.
- **Individualized Support:** Look for the case of Sustainable Green Fuel Enterprise.

4.4 REALITY CHECK: Supporting Latin American Enterprises

The Alliance is working to create a thriving global market for clean cooking solutions. Yet, the regional, country, and local markets for clean cooking solutions are all unique. They often vary due to fuel availability, cooking habits and food preferences, and the history of clean cooking programs in the region. All of the above factors have created an especially unique case in Latin America. Due to the cooking habits of a large portion of Latin Americans, cookstoves tend to be much larger, with a heavy flat surface, or plancha. The plancha stoves are difficult to distribute on a large scale. Furthermore, the number of households in Latin America that cook on solid fuel are comparatively less than Asia and Africa.[7] Finally, Latin America's enterprises often are business to government (B to G) type organizations, since solid fuel users are often given stoves for free by municipal and federal governments. These government contracts to manufacture and give away stoves are not usually available in a given region on a consistent basis and often distort commercial markets for stoves, making it difficult for enterprises to grow sustainably. The enterprises in the Latin American region found it challenging to access grant or commercial capital they needed to scale due to a lack of sustainability.

In order to help enterprises in the sector strategically plan around these challenges and eventually become a part of the larger pipeline of investible, scalable enterprises, the Alliance first started with a targeted support program for Latin American enterprises that consists of workshops on financial sustainability and gender mainstreaming for greater impact. The workshop is designed to allow each clean cooking enterprise to think through its desired scale and impact and then evaluate the financial and business model considerations.

I-Dev International

The Alliance partnered with I-DEV International to develop these workshops and conduct them in Colombia and Peru in 2014. The Alliance followed these workshops with an in-depth analysis of a sample of enterprises in the Andean region and has supported a subset of enterprises to go on to build out their sustainability and growth strategies through the Agora Partnerships' social enterprise business accelerator. The Alliance plans for these enterprises to go on to seek out grant and investment capital once they show progress on the road to sustainability and scale.

7 Map of Population Using Solid Fuels (%) 2010. World Health Organization, 2012, http://gamapserver.who.int/mapLibrary/Files/Maps/Global_iap_2010_total.png.

4.5 Idea in Practice: Partnering to Implement Your Capacity Building Strategy

Just as the Alliance partners to financially support enterprises in the sector, we find a co-pilot when it comes to capacity building as well. In fact, the Alliance partners with a large number of capacity development organizations to support the global nature of our work and the varied needs of the sector. The Alliance evaluates partners using the following criteria:

- A match of the needs of the program or enterprises and expertise of the partner
- A mission and philosophy fit of the partner, the Alliance, and the enterprises the partner will work with
- References from enterprises that have worked with the capacity development provider

There are a number of highly qualified organizations available globally to support the needs of the sector, but it does take time for business professionals to get acquainted with the clean cooking sector. In working with partners, we tend to start with short-term, small pilot programs to see if the relationship will fit, and then continue to work with the successful partnerships to scale programs. The Alliance has found that when capacity development providers work on multiple projects within a sector, they are readily able to address the challenges of enterprises within the sector. Furthermore, enterprises enjoy working with companies that are familiar with the sector because they do not have to spend so much time explaining the basics of the technology and the market potential. The Alliance has joined the Aspen Network for Development Entrepreneurs (ANDE) to meet and share best practices with a variety of capacity development service providers. The relationships with capacity development providers have evolved over time to be robust partnerships that generate new programs and areas of support as discussed in the GSBI case study in this section.

Chloe Shields

4.6 REALITY CHECK: GSBI Case

The Alliance began supporting the capacity development needs of clean cooking enterprises in 2013, shortly after it began its grants program to support clean cooking enterprises. The Alliance staff always knew partnerships would be an essential piece of the capacity development strategy. Our goal was not to try to be an expert in everything or be everywhere, but to leverage the ongoing work of experts in social enterprise capacity development. The Alliance's partnership with the Global Social Benefit Institute (GSBI) out of Santa Clara University started with promotion of the GSBI programs to Alliance partners and has evolved to a strong partnership to support the business capacity needs of the sector. In 2013 the Alliance supported three early stage clean cookstoves and fuels companies to attend the six-month-long online accelerator program. From there, the Alliance and GSBI have collaborated to support a number of Spark Fund finalists to attend GSBI's year-long accelerator program aimed at more individualized support for growing companies.

Noting that there was still a gap in supporting grassroots companies to attend accelerator programs—nearly 95% of applicants to accelerator programs are rejected—the Alliance and GSBI decided to collaborate on the development of a high quality open course that would be available to a wide number of Alliance companies. Through stakeholder consultation, we learned that this could not be an online course due to the nature of internet connectivity in Alliance focus countries and entrepreneur learning preferences. The result was the development of the GSBI Social Enterprise Boost Program. Key elements of GSBI's high quality curriculum is condensed into a three-day workshop, in a classroom setting, where entrepreneurs work together on a plan for growing their enterprises in a sustainable manner. Entrepreneurs should leave the Boost workshop with the tools to apply for future funding and training programs. To date, the Alliance has piloted this program in Kenya, Uganda, Ghana, Bangladesh, and China, training more than 125 enterprises. We continue to partner with GSBI to look at ways to decentralize the Boost program, leading to rapid scalability of the training.

Ranyee Chiang, Global Alliance for Clean Cookstoves

4.7 Idea in Practice: Capacity Building to Support Investment

The Alliance provides individualized capacity building for companies when it wants to truly leverage the impact of growth financing. The financing an enterprise receives is only effective if it translates into building capacity to serve its target market and grow its enterprise. The Alliance sees that there are five steps to implementing an individualized capacity support program to complement financing:

1. Assess the enterprise's growth plan through reading the business plan and conducting market, financial, and operational due diligence on the company.
2. Understand the current capacity of the company to implement the growth plans— this can also be determined by due diligence, assuming that the due diligence is designed to include a capacity assessment.
3. Compare the growth plan with the capacity assessment—are there risks or potential bottlenecks that would not allow the growth plans to be implemented?
4. Fund technical assistance to mitigate risks or bottlenecks in step three alongside the financing support for the growth initiative.
5. Whenever possible and needed, help the company find the right service provider.

The gap between an enterprise's growth plan and capacity to implement it is one that commercial investors also come across when investing in social enterprises. This trend increases the risk to the investor and causes a reluctance to invest in funders like the Alliance. In response to this challenge, the Alliance has a Capacity Building Facility (CBF) designed to strengthen the supply of clean cooking solutions by financing technical assistance for clean cookstoves and fuels enterprises along the value chain, increasing their ability to achieve scale, ensure commercial viability, and leverage private investment. The Alliance's CBF is designed to fund capacity building for clean cookstoves and fuels companies that are ready to scale and able to obtain long-term capital. Ensuring sufficient supply of clean cookstoves and fuels is critical to the adoption of clean cooking solutions, and both long-term investment and capacity building are key to scaling up supply. The Facility will do the following:

- Partner with impact fund managers to increase investment in the clean cooking sector, by providing access to capacity building services such as strategic planning, financial management, etc., to strengthen their underlying investment;
- Finance the cost of capacity building to leverage grant and investment capital;
- Work with Alliance partners to prioritize the sector capacity building needs of clean cookstove companies, including the incorporation of gender considerations into capacity building delivery; and
- Encourage the development and use of local service providers to help create jobs and strengthen indigenous markets for the sector.

The capacity building facility is aimed at combining capacity building with finance to strengthen the supply of clean cooking solutions, a crucial part of the complex road to clean cookstove adoption.

CAPACITY BUILDING + FINANCING = BUSINESS SCALING ➤ CLEAN COOKSTOVE ADOPTION

The Alliance is still in the process of working partnering with fund managers to deploy the first technical assistance grants under the CBF, but it has already partnered with two impact funds to begin piloting the program. Visit http://www.cleancookstoves.org/resources_files/capacity-building-facility.pdf to learn more about the CBF and how the program works.

Individualized capacity development support to complement financing is time consuming, and often enterprises need support in multiple areas, as discussed in the SGFE case study in this section. However, the Alliance has seen enterprises like SGFE use this support to better position themselves to achieve scale quickly.

4.8 REALITY CHECK: SGFE Case Study

Sustainable Green Fuel Enterprise (SGFE) has been both a Pilot Innovation Fund and Spark Fund grantee. Before receiving support under the Pilot Innovation Fund (PIF), SGFE was truly a start-up company that had spun out of the NGO Geres. Before applying for PIF funding, SGFE had the capacity to produce 20 tons of char-briquettes per month, providing a sustainable supply of greener fuel to approximately 200 households and small businesses per month. They identified distribution as a key bottleneck to scaling up and used PIF funds to test a hub and spoke, or decentralized distribution model. While the model did not work with the original partners that SGFE had intended to engage, the model did work, and soon SGFE's CEO, Carlo Figa Talamanca, was not able to meet the increased demand for fuel. He was able to allocate PIF funds to increase production. As a result of the new distribution and increased production implemented by SGFE during their PIF grant, SGFE had the capacity to produce 40 tons of char-briquettes per month, providing a sustainable supply of greener fuel to approximately 500 households and small businesses per month. SGFE then leveraged their success and lessons learned to apply for a Spark Fund to scale their company, this time planning ahead for the increased production needs. Before awarding SGFE with a Spark grant, the Alliance conducted due diligence, revealing that they needed support in the areas of accounting and business management, raw materials availability, and gender mainstreaming. These findings became the basis for SGFE's individualized capacity building support.

In the area of business management, SGFE needed to implement basic accounting and tax management systems. Furthermore, they had not yet undergone a financial audit, a requirement for follow on funding from a commercial investor. So, SGFE and the Alliance agreed to allocate a sizeable portion of the Spark budget to pay for an accounting system, a consulting firm to implement the system, and an audit. Furthermore, SGFE used the Spark award along with Ashden Award prize money to implement a sales, supply chain, and distribution management system, and supporting staff to develop and implement the system. SGFE selected its own consultants for this project but kept the Alliance updated as the work progressed.

As a fuel production company that depends on the availability of raw biomass, there were potential concerns about SGFE's plans to expand production from the current 40 tons per month to 100 tons per month. The Alliance was particularly interested in demonstrating that the product does have a net positive impact on the environment over traditional charcoal and that the new factory would not be underutilized due to a lack of available raw biomass. To mitigate these risks, the Alliance contracted with the consulting company ENEA to conduct a life cycle analysis (LCA) on the fuel and analyze raw material availability, including possible alternative sources of raw material. You can find out more about this work and the final result in the Alliance's webinars on YouTube: https://www.youtube.com/watch?v=4AmEmm3Enr4&list=UUVWC67A7VcBK8rSFh0h_xKg.

When Talamanca was interviewed about SGFE's gender mainstreaming strategy he had already known that women were integral to his supply chain. They were the overwhelming owners in retail shops, and also prevalent in restaurants that made bulk orders from his company. He also found that hired women were more reliable than their male counterparts, even if they didn't want to provide heavy manual labor. However, he didn't have a set strategy for including women—his actions were primarily reactive, rather than proactive. The analysis during the due diligence and the follow on gender support through the Spark Fund revealed that SGFE didn't disaggregate their data by gender, and didn't address gender concerns throughout the supply chain—such as including women in the design or feedback process. As an added part to the Spark grant, the Alliance contracted with a gender expert to support SGFE's gender mainstreaming strategy. Talamanca welcomed the gender expert sent by the Alliance as part of the Spark Fund. The expert walked through every aspect of SGFE's supply chain and created a gender action plan based on the Alliance's best practices guidebook, *Scaling Adoption of Clean Cooking Solutions through Women's Empowerment* [http://www.cleancookstoves.org/resources_files/scaling-adoption-womens-empowerment.pdf].

“She doesn’t have a magic wand,” Carlo explained. Instead, the expert would ask questions about practices or actions that were taken for granted and try to figure out the cultural reasons behind them. In some cases, the problem was tangentially a gender problem, but at its heart a poverty problem. “Now we start to include them [women],” explained Carlo Figà Talamanca, “Not just because we want to do good, but because it will also help us do better business.” Talamanca and the gender expert worked to create a matrix of possible solutions and ranked them by long-term effectiveness and the risk reduced. As a next step, Talamanca will review this and other suggestions to decide the next course of action.

Today, SGFE is on track to complete all of its growth objectives under the Spark Fund. In addition to creating a quality product that consumers love, SGFE has begun to transform the culture of the company to be more inclusive and recognized as an environmental leader in Cambodia. They are also in final rounds of discussions with an impact investor to close a first round of quasi equity investment.

Sustainable Green Fuel Enterprise

4.9 Idea in Brief

Capacity building combined with financing keeps enterprises on the road to scale. When designing capacity development programs, it is important to decide whether you will be supporting a discrete number of enterprises or whether you want to focus on developing a pipeline of enterprises in order to continue building the market when some enterprises graduate out of your enterprise support programming. The Alliance has taken a pipeline approach that supports general, tailored, and individualized programming for capacity building. Furthermore, partners are essential to capacity building since no single organization has expertise in all the operational areas where clean cooking enterprises need support, and few can realistically provide support at all levels (general, targeted, and individualized).

Conclusion: Arriving at Your Destination

After working with enterprises to access financing and build their capacity, you have hopefully arrived at, or are on track to arrive at your destination—a strong supply of cookstoves and fuels in your target market. This toolkit is expands on *Step 6: Drive Investment and Scale Enterprises to Meet Consumer Need* of the ten-step strategy to catalyzing markets, outlined in the Alliance's Partner country toolkit, and is meant to provide the steps and tools for partner countries and market builders to replicate the Alliance's enterprise development programs. The toolkit also includes valuable lessons that the Alliance has learned on our journey to scaling enterprises globally and cases of enterprises and partners that we have worked with to strengthen the supply of clean cooking solutions.

In addition to learning the essentials of the road trip to scale, there are a few underlying themes that arise in every part of the journey. First, an initial assessment of enterprises in the market is an underpinning of any access to finance or capacity development program developed to grow the enterprises. Additionally, capacity building is not a separate step that happens before or after an enterprise receives finance, but is a part of the journey at all stages of enterprise growth. Finally, co-pilots are essential, whether they are consultants helping with enterprise assessment, co-financiers, or capacity building experts in a subject matter area. No one entity can go the journey alone.

There are, of course, situations when enterprises and markets will face barriers that cannot be surmounted by enterprise finance and capacity building. Public, private, and non-profit actors need to work together to build the market for clean cooking solutions. That is why the Alliance and its partners work to support enterprises as part of a broader three-pronged strategy to strengthen supply, enhance demand, and foster an enabling environment for clean cooking solutions.

Chloe Shields

Glossary

A **clean cooking enterprise** is a for-profit or non-profit entity with a revenue generating approach, that participates in the clean cookstoves or fuels value chain.

A **convertible grant** is another financing instrument with hybrid capital character. The social investor provides the enterprise with a grant that is converted into equity in the case of success.

Debt capital (loan) can be used for long-term investments or project financing that promise stable and predictable cash flows over the next several years. The stable and predictable cash flows are necessary as the debt capital providers receive an annual interest payment. Debt capital is provided on a temporary basis and requires repayment after a few years. Normally, the loans are provided for five to seven years.

A loan is attractive if the social enterprise has access to stable and predictable cash flows. The financing terms include:

- Interest rate
- Repayment schedule
- Financial flexibility
- Default scenarios

Equity capital is the financing instrument with the highest risk for the investor. The social investor gives the social enterprise a certain sum in exchange for a share of the company (e.g., 10% of total shareholdings). The social investor receives no regular annual payments but a share of the profits generated by the social enterprise. Besides a share of future profits, the social investor has certain control and voting rights. Control and voting rights depend upon the legal form of the enterprise and are usually structured in the contract between investor and investee.

In exchange for an investment, the social investor buys participation in the equity of the social enterprise. The social entrepreneur has to negotiate the following terms

- Valuation of the social enterprise
- Dividend payments
- Exit/repayment

A **forgivable loan** is a loan that is converted into a grant in the case of success. If the social enterprise reaches the goals agreed on beforehand by the investor and investee, the loan does not have to be repaid.

Grants are a traditional form of financing in the social sector that are provided by foundations or individuals and continue to be an important funding source for social enterprises. Despite their importance, there are some shortcomings related to grants. Grants are regularly provided only for certain projects and usually exclude overhead costs and expenditures for the development of the social enterprise. Furthermore, grants are usually short-term, not predictable, and impose high fundraising costs on the social enterprises.

Hybrid capital contains elements of grants, equity, and debt capital. The grant character can be explained through the fact that there are no interest costs and, in certain pre-agreed scenarios, the financing instrument is converted into a grant. Financing instruments with hybrid capital character include recoverable grants, forgivable loans, convertible grants, and revenue share agreements described below.

Mezzanine capital combines elements of debt and equity capital and represents a convenient financing alternative if pure equity or debt capital is not applicable. The interest payment can be linked to the profits of the company, whereas the total amount is repaid after a certain time period or converted into equity capital. The structuring flexibility makes mezzanine capital an attractive option for social entrepreneurs as well as social investors.

A **recoverable grant** is a loan that must be paid back only if the project reaches certain previously defined milestones. If the milestones are not reached, the recoverable grant is converted into a grant. This mechanism can be used if success of the project enables the social enterprise to repay the loan to the social investor.

Revenue share agreements are financing instruments with which the investor finances a project and receives a share of future revenues. This risk sharing model can be used for the repayment of the financing and gives the social enterprise financial flexibility.

Royalty finance provides the investor with a percentage of the revenues of the company, meaning that when revenues do not exist or are low, there is little downside for the company, but there is upside for the investor when the company is successful.

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