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SPOTLIGHT
on Inclusive Business

Business Innovation Facility

Inclusive business looking for finance?
What is available and how to target your best solution

Entrepreneurs know when they need finance to support their inclusive businesses, but may struggle when determining which type of finance – or more likely which combination – is right for their business. Applying for financing takes considerable time, so it's important to invest it wisely. This Spotlight gives a brief introduction to the financial landscape, providing an overview of what financing is available and presenting some considerations for each.

Types of finance

There are three main types of finance available to an inclusive business – equity, debt and donor income.

1) **Equity** – The expectations of equity providers vary widely. On one end of the spectrum are private equity investors, who will expect a market return and an exit from the investment after a few years. On the other end are ethical investors, who are often investment arms of charitable organisations. They will accept lower financial returns and are more patient about their exit timing, but also expect social/environmental impacts to be delivered. In the middle are a growing class of *impact investors*, most of whom will still expect a full financial return as well as demonstrable ethical impact.

2) **Debt** – Debt also comes in varying forms, from a simple bank overdraft facility to a 'straight' loan that repays interest and capital over a pre-set period. A third option is bonds, which allow for capital to be repaid in total at the end of its term. Debt products are also available for specific aspects of a business, such as capital expenditure leasing or targeted working capital facilities.

3) **Donor Income** – Donors have become more aware of the potential positive social and environmental impacts that the private sector can achieve. As a result, grant income has increasingly become available to support inclusive business plans that produce ethical outcomes. Donors may provide direct grants, soft loans, subsidised equity investments or expert assistance.

Things to consider

It is good to have a healthy mix of debt and equity. A business that has high levels of debt compared to its equity base may be viewed as too risky, while businesses that have low borrowing may well be expected to raise any required finance as debt. Different inclusive businesses will require different types or 'mixes' of finance – a 'one size fits all' approach is not recommended. In coming up with the best mix of financing for your inclusive business, overleaf are some useful points to consider:

Inclusive Business Spotlights shed light on specific topics concerned with the development of inclusive business. They are generated from the project and advisory work of the Business Innovation Facility and Innovations Against Poverty.

Finance Type	Upside	Downside	Considerations
Equity	• No financial cost until the business is profitable	• Reduces your ownership stake in the business	• The amount of equity you give up and at what cost will normally be up for negotiation • Look for investors that come with an 'added value', such as expertise, industry contacts or other technical support
Debt	• Does not dilute your ownership stake • Payments are fixed, and will not rise with profits	• Repayment of interest and capital is required even when the business is not profitable	• Debt providers will likely require business or owner assets to collateralise the loan
Donor Income	• Effectively 'free equity'	• May come with other burdens, such as reporting on ethical impacts	• Understand what positive social/ environmental impacts your proposed venture plans to deliver • Be clear on what responsibilities come with donor support before investing time in applying for it

No matter which type of financing you are seeking, it is worthwhile investing time in establishing a positive relationship with your debt provider, investor or donor. If an initial transaction works well, then it is often easier working with the same parties on future deals.

Some examples

- An inclusive business experiencing rapid growth will need working capital in varying forms. Having flexible stock and contract financing can help the business match its debt financing to actual needs, and the value of the stock and contract values could be used to secure the loans.
- A successful business needing to invest in new equipment, improvements to systems and increases in personnel may need equity investment to support the expansion. Alternatively, a mix of debt financing for the new equipment, and equity financing for the systems and personnel investments could work better.
- A start-up business needing funding to cover initial capital expenditures and initial operating expenses and working capital may find a pure equity investment most appropriate, given the risks associated with start-ups. However, a mix with some debt finance could also work as well. Additionally, if strong social/environmental innovation and projected impacts can be demonstrated, then donor funding might be available to 'de-risk' the proposition in the eyes of debt/equity finance providers.

Additional Resources

Inclusive Business Support Database – a 'one-stop shop' for information on over 200 organisations that offer financial and/or technical support to inclusive businesses
http://businessinnovationfacility.org/page/data-of-financial-and-technical-support-for-inclusive-businesses

Are you investment ready? – a *Checklist* of things to consider when assessing whether your business is ready to attract investment
http://bit.ly/checklist-invest-ready

Innovative Business Planning – The *Know-How* section on the Practitioner Hub which looks at innovative ways for inclusive businesses to meet both commercial and social objectives
http://businessinnovationfacility.org/page/innovating-business-planning

Recommendations

1) Be prepared!

Knowing how much finance you need, for what areas of your business and over what timelines will enable you to present your case to any targeted financier with confidence. Finance providers will be impressed if you are targeting a specific financial structure that will serve you best. By being clear and certain, you will likely be viewed as lower risk, potentially getting you a better deal (see *Checklist* and *Know-How* links below). You also won't waste time chasing financing you don't need or can't get.

2) Get advice if you need it!

If business/financial planning is not your specialty, consider bringing in support to get a comprehensive plan in place. Producing something that might be either incorrect or unimpressive will cost more in the long run. It may also be worthwhile getting support when initially identifying, connecting and dealing with potential finance providers.

This Spotlight was created by Duncan White whilst working on a Business Innovation Facility supported project in Malawi.

For further information and to view other Spotlights, go to:
Practitioner Hub on Inclusive Business: **www.businessinnovationfacility.org**

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