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THE LANDSCAPE OF FUNDING TOOLS

This note summarises some of the tools which can be used by governments, agencies, investment organisations and foundations, to provide funding for projects and organisations (many of which Nesta has experience of). These range across the continuum from pure grants designed to achieve public benefit, to very commercial investment primarily designed to achieve a private return.

FUNDING TOOL	DESCRIPTION	ADVANTAGES	CHALLENGES
GRANTS	Gift of money, usually linked to commitments on activities, outputs or outcomes.	• Simple, established.	How intensively to manage, can drive dependency. No return to funder.
R&D FUNDING	Stage-gate funding for developing technologies etc., usually grants.	• Suitable for high risk/ reward projects.	Requires greater management. Staging can limit project flexibility.
GRANTS/EQUITY IN ACCELERATORS IN STAGE-GATE	Grants plus small equity shares for new companies, often linked to non-financial help.	• Higher success rate for startups.	Intensive input needed to achieve successes.
GRANTS CONVERTIBLE TO LOANS, OR GRANTS WITH ROYALTIES	Grants with conditions that make them turn into loans once milestones are met, e.g. on revenues.	• Recycles money. • Drives good behaviours re: financial sustainability.	Managing loan book - requires longer-term engagement/ communication with awardees to check on revenues; management of repayment schedule. Modelling of repayment will often be overly optimistic. Can be gamed if repayment triggers are not set right. Tax/accounting treatment not well established.
GRANTS CONVERTIBLE TO EQUITY	Grants which turn into rights to equity once revenue or other milestones are met.	• Recycles money • Share of high-value projects.	Managing investment, follow-on funding, getting the conversion triggers right. Only feasible if recipients established with shares. Tax/ accounting treatment and legal enforceability not well established.
MATCH CROWDFUNDING	Committing money on condition that matched funding is raised through crowdfunding platforms.	• Encourages mobilisation of public money and commitment.	Skews to high income audiences; sums still quite small.
LOANS	Money lent to be repaid with interest over agreed timescale.	• Recycles money. • Straightforward offer to recipients (no cession of control or ownership). • Easy to value cost and likely return.	Managing loan book, risk assessment, security and seniority. Is there additionality? Many firms can get loans from other sources.
PROJECT-SPECIFIC LOANS	Loans linked to specific projects, e.g. in technology, repaid only if the projects succeed.	• Recycle money. • Straightforward offer to recipients (no cession of control or ownership). • Attractive to recipient as do not need to be repaid if project fails.	Less secure than loans secured against the firm as a whole (see above). Need to monitor project success to see if loan needs to be repaid (this can be gamed).

CONVERTIBLE LOANS	Loans offering rights to convert into equity.	• Gives lender chance to participate in upside in case of radical success, while still promising repayment in base case.	Less attractive to funded organisation than loans or equity. Funder needs to manage conversion process.
QUASI-EQUITY	Loans offering revenue participation rights (e.g. shares of revenue or profit over given levels).	• Encourages business growth. • Recycles more money from successes.	General challenges of oversight, monitoring etc.
IMPACT BONDS (SOCIAL, DEVELOPMENT ETC.)	Funding raised from philanthropy or capital markets linked to commitment of payments linked to outcomes.	• Shifts risk from government. • Encourages focus on evidence and outcomes. • Can bring in new skills.	Relatively few fields with suitable conditions; still young model in experimental phase.
VENTURE EQUITY INVESTMENT (AND IMPACT VENTURE INVESTMENT)	Investment in equity in early stage companies, usually with aim of achieving significant growth in value, and usually linked to active involvement in management, strategy etc. Impact investment uses similar methods but also aiming to demonstrable social impact.	• Funder can participate in upside. • Funder gains (some) control in firm. • Allows rigorous linking of investment and outcomes (e.g. using standards of evidence).	Intensive management needed for realising value and need for follow-on funding (B, C, D rounds) in order to realise value. No return to funder unless firm floats or exits. Not generally applicable to large firms or organisations that are not firms. If funder is charity, link to objects and public benefit must be monitored.
INTERMEDIARY FUNDING	Funding directed through intermediaries (e.g. on Big Society Capital model) which then invest loans, equity etc., in firms or social enterprises. Usually investors represented on investment committee.	• Can increase funding flows (e.g. with co-mingled funds). • Creates more specialist capacity and some healthy competition. • When working well interest from loans covers management costs.	Difficult to exit. Average venture capital returns very low. Sometimes challenges raising matched funds; achieving sufficient scale; and handling timescales of investments and returns.
CHALLENGE AND INDUCEMENT PRIZES	Commitments of funding tied to proof of ability to solve a novel problem.	• Awareness raising, expectation that goal for winning is high - raising the bar. • Good for where market incumbents have little incentive to innovate. • Attracts new entrants, rewards success, favours technological/product based innovation.	Defining success - ambiguity reduces effectiveness of intervention. Requires firms to spend money ahead of receiving funding, so capital constraints may still be a problem. Challenge of setting the right goal: requires expertise and is difficult to change once set.
REVENUE-BASED FUNDING MODELS	Releasing grants or loans in response to reaching revenue targets	• Aims to encourage trading and entrepreneurship, as opposed to grant dependence. • Used in development, technology funding, self-employment and other fields.	Revenue results achieved can have many causes; may therefore provide capital where it's not needed; conversely can push recipients to maximise short-term revenue rather than long-term business building.
GOLDEN SHARE	Equity finance linked to a special share which cannot be diluted, or offers special voting rights.	• Opportunity to participate in upside without follow-on investment. • Gives funder control over firm.	Represents a significant concession for organisation receiving funding. May deter future equity investors.
SERVICES CONTRACT TO SUPPORT INNOVATIONS	Procurement of services from small firms, charities or social enterprises as a way of helping them grow or innovate (e.g. SBIR).	• Use procurement process to support small innovative entities.	Reliance on relatively untried service provider.

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