Financing

Social Enterprises

WP4

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Jointly for our common future

FOREWORD

Ease&See, a project funded by the European Union under the South East Programme, focuses on innovative social entrepreneurship which considers Social Enterprises being active players in the business community and not only in the welfare system. Ease&See aims at **strengthening the relationships of social enterprises with "traditional" businesses and the financial industry**, implementing **concrete solutions** to support economic development and networking at local and European level and **foresees a new role for public actors as facilitators of new economic development processes**.

This Executive Summary is aimed at providing an overview of the main financial topics which have been discussed and analyzed during the project and at describing issues and opportunities in this field.

FINANCE & SE, NEW CHALLENGES AND PERSPECTIVES

The financial industry, at least in some countries, is more and more looking at social enterprises as a potential new market. They attractiveness is justified by their reliability, dynamism, high impact (social, employment and economic). Additionally, there are some **"external" conditions** which reinforce this concept: a) their fields of operations are essential to preserve current welfare systems, b) their main competitor or co-petitor (the State) is pulling back from many service areas , c) the financial capitalism is "under attack" and has a need to share value and reinvent its social role.

If we are aware about the fact the finance is playing a relevant role, we should also ask ourselves what it is looking for. While there is evidence that the financial industry is now capable of approaching and understanding the social mission and role of social enterprises, there are probably some main traditional "business" features that are still milestones or essential in selecting not only to be funded projects but also their proposer. We may list these criteria as follows: SE need to be

- "**large**", which means also to have the capacity of asking for and being able to invest large financial stocks: this represents nowadays a problem due to the fact that most of our social enterprises are small
- "**scalable**" in terms of provided solutions which means that innovative services or products which are delivered or produced thanks to investments must be replicable and transferred this expanding the business: even this is not easy especially f we think that most of the innovations we are talking about refer to welfare and are therefore related to specific contexts which may be difficult to be found elsewhere
- "**efficiency driven**": banks are no longer only providing financial resources but also the necessary support to make that resources being used properly and therefore look for SE managers who are able to think and act in this direction
- "**co-financing actors**", which means that financial beneficiaries should be able to contribute to the investment

If we read carefully these requirements we may probably notice that – referring to an article published by the Economist - "There is a risk that BSC (Big Society Capital ndr) will have so much cash and so few decent places to invest". **There is a mismatch between available resources and the capacity of attracting these resources** which means that one of the main goals also of the EASE&SEE project should be to play a role in minding the gap between demand and offer.

Financing Social Enterprises in Europe

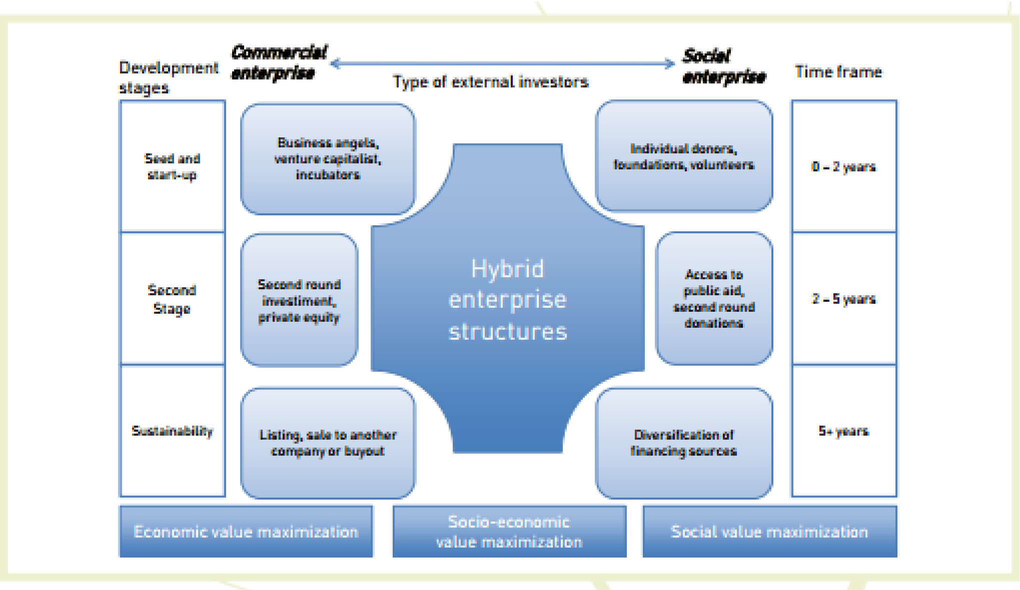
Main type of financial instruments

There are two main types of external financing:

a) **equity** (or investment financing): the lender participates in the share capital and receives a share of profits

b) **debt** (or loan financing): a loan that will be repaid as constant installments (regardless of the company results).

It is possible to represent the various instruments by ideally arranging them on a straight line (see the figure below) based on the repayment priority (hence the investment risk). On the two opposite sides we will find on one hand ordinary shares since they receive a return only after all the other financial tools and on the other hand various types of secured debt (bonds). Between the two there is a range of "hybrid"/equity-like instruments which combine debt and equity features which are ascribed to the so-called mezzanine-finance.



The characteristics of financial forms for social enterprises can be summarized in the table below

	Grant	Patient Capital	Equity	Equity-like	Loans
Expected loss %	100%	20-50%	10-20%	10-20%	1-8%
Return on investment	0	-50%-10%	Unlimited	Variable up to 30%	Fixed 5-18%
Investment timeframe	Usually for a short term	Repayment Holidays	Undefined (depends on the enterprise success)	5-7 years	Set
Involvement in management	Low	Discreet	High	High	Low
Exit	Not applicable	Repayment of capital	Listing, Sale to another enterprise, Buyout	Royalty, Repayment or listing	Repayment
Liquidation rights	None	None/ subordinated	Remaining	Subordinated	Priority
Voting rights	None	None	Yes	Defined by the conditions	None

Is there also a "third way"?

The EASE&SEE project provided evidence of a possible **third way to finance** which cannot be considered as being a substitute to financial resources but – merely – as sort of "preliminary intervention" which may support the raise of new (or improved) economic initiatives without applying immediately for financial means.

This role – public actor as business facilitator" may be illustrated using the figure below. A facilitator, as it has been experienced in the project,

- helps social enterprises in a business to reach an outcome or decision for which everyone will take responsibility and be fully committed (**Goal 1**)
- helps by providing a "structure" to a process (**Goal 2**)
- can accelerate processes simply by "sharing" its main functions and make them available to the community in a transparent and effective way (**Goal 3**)

Last but not least, a facilitator does not lead, but rather guides: it doesn't offer solutions or recommend decisions, but rather helps the group discover solutions and brings together resources that are out there but are still not linked to concrete business needs.

Specifically, if we apply the above listed Goals to Social Enterprises, a facilitator

- may provide social entrepreneurs with a professional who helps them to better focus their new business goals and identify which could be the different ways to reach it (for instance by involving technical staff which is in charge of market regulations, public service delivery, networking, granted training schemes, etc.) – **Goal 1**
- may easily connect the several actors who are delivering "open accessible" services at local or regional level (acting as the main hub for social enterprises) and accelerate the way social enterprises find the most appropriate support to start innovation, new business activities, etc. – **Goal 2**

- may support the uptake of local economic activities by better finalizing its own “institutional” goals and activities and align them to real local or regional business scenarios. – **Goal 3**

All these interventions may dramatically reduce, at a first stage, the need for money and accelerate business processes. This does not mean that at a certain stage, finance will again take its momentum. Even at this latter stage, facilitators may support the process and guide social enterprises towards the most appropriate channel.

How is the EU contributing

Strategic use of funding tools

A starting point should be to target areas of market and government failure and those with the greatest potential for pan-European impact, the greatest added value and the greatest chances of enhancing overall impact and supporting EU policy objectives of smart, sustainable and inclusive growth. These are likely to include very-early-stage innovations, growth finance in new fields, and activities involving significant levels of both risk and reward. The principle for the use of funding tools should be the innovation life cycle. The EU recommends that different types of finance be made available at different stages. Public funding is needed most during the early stages, when risks may be high and rewards uncertain: the more disruptive the innovation, the more uncertain the outcome, and the higher the risk. Other fields of innovation – such as medicine or technology – have sophisticated mechanisms for funding at this early stage. However, the social innovation field lags far behind.

The EU financial checklist provided by Social Innovation Europe

Social Innovation Europe wrote down a list of 4 main investment priorities in the field of social innovation, which are a) Investment in ideas (support for incubation capacity will give new impetus to the field of social innovation); b) Investment in prototypes and pilots (taking innovation to the next stage beyond ideas involves testing ideas in practice); c) Scaling – new investment funds (potentially joint with foundations and banks: the next stage of support should focus on the adoption of successful social innovations by national, regional and local government). Encourage business engagement: as well as mobilising public money for social innovation, there is also a need to mobilise private funds to support it.

Fund management arrangements for EU and other public funds will need to develop and new mechanisms will be needed to promote equity or quasi-equity approaches and appropriate forms of risk sharing.

The Social Business Initiative and Social Entrepreneurship Funds

The Social Business Initiative launched in 2011 identified three strands of action to make a real difference and improve the situation on the ground for social enterprises: 1) Improve the access to finance, 2) Give more visibility to social enterprises, 3) Optimise the legal environment. Since then, a lot has been achieved. The EU institutions have delivered in all three areas. Public money has been mobilised to help social enterprises. The **Employment and Social Innovation programme** has been made available to social enterprises to support the development of the social investment market with €85m and to facilitate their access to finance through quasi-loan instruments from 2014-2020. For the same period, the **Structural Funds** have been reformed to enable Member States to earmark structural funds to finance social enterprises. But the sector also needs private investments. This is why Europe has established the instrument of a **European Social Entrepreneurship Fund** to help social enterprises get easier access finance and aid investors to identify investments in social business. **Social Stock Exchanges** are also being developed further to create a European platform that allows the trading of shares in social enterprises on a Financial Services Authority regulated stock exchange. In addition, crowd funding is growing in importance. Work is being carried out to collect more information on internet-based fundraising across Europe and to identify what added value EU action could bring.

The Social Impact Accelerator (SIA)

The Social Impact Accelerator (SIA) is the first pan-European public-private partnership supporting social enterprises. Launched in May 2013 with the collaboration of private sector investors, SIA is a pilot initiative which aims to address the growing need for availability of equity finance to support social enterprises. This segment of the business world is becoming increasingly instrumental in promoting social inclusion, providing alternative sources of employment for marginalised social groups, and contributing to growth. SIA is a first step in the EIB Group's (European Investment Bank and EIF) strategy to pioneer the impact investing space and respond to the wider EU policy aim of establishing a sustainable funding market for social entrepreneurship in Europe.

THE STATE OF THE ART IN THE EASE&SEE COUNTRIES

Austria

Traditional social organisations are still focussed on getting financed by public funds (state/provinces/municipality etc).

A very low number of social organisations are offering their products or services only on the free market, meaning that they are totally independent from public funding.

In the last years, there is a new tendency that social enterprises try to find private investors in order to finance their business activities.

Main issues	**How to mind the gap: proposal**
SEs financed either via the National Employment Service or the Social Federal Welfare Office are strictly bound to their annual budget plan: they are not allowed to build up financial reserves. Without having any financial reserves in their back, there is no security for times in crises and what is more, there is no money available for new innovations. The split legal situation about the responsibility for the financing of the social enterprises[1]. There are target groups that are treated under federal law and other target groups that are treated under provincial law. This regulation makes it very difficult in Austria to implement regulations on a nationwide level. Social enterprises tend to be very small which makes a financing quite inefficient	Legalization for social enterprises to build up financial reserves (for example the half of their generated revenue). The establishment of a better access to financial resources (e.g. bank loans) for social enterprises, for example: the public sector is taking over credit guarantees for social enterprises. New project innovations should be fostered by supporting the financing via a Co-Financing Fund that could be implemented on a nationwide level. A very quick transfer of payments on all levels would be an advantage for the financial situation of all social enterprises. Introduction of social criteria in the public tendering process would help social enterprises in a financial way.

[1] The most relevant document which can be mentioned is "The Non-Profit Sector in Austria – An economic, legal and political appraisal (Working Paper 01/2007, Institut für Sozialpolitik WU Vienna)" – please find the report attached

Bulgaria

Most of the non-profit organizations and social enterprises are oriented toward public funds in order to support and finance their programs and plans. This situation shows a big lack of knowledge and awareness of sustainability by Bulgarian social enterprises, especially in making real and sustainable business.

As consequence, the majority of the Bulgarian social enterprises don't pay attention and don't look at the market and the private investors in order to develop commercial and business relations and eventually to get financial support.

On the other hand, many profit companies in Bulgaria, in order to apply their principle of corporate social responsibility, want to match and develop business relation with social enterprises, giving to them a concrete opportunity to enter in the market and to develop their own business.

Main issues	**How to mind the gap: proposal**
that in the Bulgarian legislation there is no legal definition of social enterprise, there are not any rules that regulate their status, form and activities. Lack of awareness and understanding of social enterprises and their role in the community. Lack of competitiveness is one of the most difficult obstacles for the social enterprises to overcome. The quality of social-enterprise products is not always up to standards, for two reasons. First, the people from the targeted social-services groups, who lack appropriate skills, often are involved in the production process. Second, product or service quality is not usually uppermost in the minds of the social-enterprise managers, who tend to focus on the social aspects of their organizations	ensure better awareness and promotion of the benefits and general impact of social enterprises to the economic and social development of the country and society at large. get a social enterprise to "think" and "behave" like a business, not a charity

Hungary

The majority of Hungarian social enterprises are applying for EU funds; they do not take any other refundable support (e.g. long-term microcredit). The reason for this in most cases is that social enterprises are not creditable, they do not have any estates, any own resources that would serve as own contribution. Indeed the main focus is currently planning and the distribution of EU funds for the 2014-2020 period.

Currently only organizations employing people with changed working capacity (people who live with some kind of disability, or some kind of illness and therefore are unable to work full-time) get some non-refundable state support.

Private investors usually turn up in social cooperatives: they are the founders. They usually start enterprises with a minimum founding contribution. It is not possible to involve legal persons as investors, this is excluded by law. Only local governments, minority governments, and some charity organizations can be a member of a social cooperative. The majority of non-profit limited liability companies are owned either by the state or by local governments, in their case there are no private investors.

Main issues	**How to mind the gap: proposal**
Definition problems which have limited until today the introduction of transparent and clear mechanisms to support them and to increase their role in the economic environment. There are many regulations related to SMEs, of which SEs have been left out. The Hungarian State forgot about this sector, while the banks do not undertake working out its financing portfolio. Social enterprises do not get credit, because they do not have enough guarantees for getting a credit(they lack resources in terms of infrastructure, assets and resources). Social enterprises became tender-dependent, they live from support to support they closely rely on the state, on the institutions of the local government, distracting their attention from doing their business on the market. They often do not expect their survival from market solutions	Improve the infrastructure and to get estate(s) for them, similarly to SMEs. A portfolio necessary for getting development and investment credit should be needed. For that, a common will of the Hungarian State and the bank should be necessary. It is often told about SEs that they lack the knowledge, the expertise and the human resource necessary for the enterprise. In order to be able to get them, tender resources would be needed, that would provide incubation support for these enterprises. Incubation systems should be established, helping enterprises managing daily problems, and relieving them from certain functions e.g. taxation issues, book-keeping functions, marketing, market research, human development. In order to be able to embed in the local economy, it would be inevitable to cooperate with the profit and the state sector.

Italy

Financial actors are no longer to be considered as mere stakeholders but will play an increasing role in the development strategies of social enterprises. Only a few years ago, if we wanted to have a picture of the social enterprises or of the wider social economy environment, we had to investigate topics like the labour market, the relationships between public administrations, the intervention models within welfare systems, the different entrepreneurial approaches adopted. Nowadays the focus has **switched to finance**, and most of all to private finance.

Main issues	How to mind the gap: proposal
"There is a risk that BSC (Big Society Capital ndr) will have so much cash and so few decent places to invest". **There is a mismatch between available resources and the capacity of attracting these resources** which means that one of the main goals also of the EASE&SEE project should be to play a role in minding the gap between demand and offer. There is still a conservative approach of several SEs to finance. SEs and SMEs have been facing the same difficulties in approaching the financial market over the last 2-3 years. Additionally, the venture system in Italy is still far by being competitive and exhaustive in terms of offer and services.	Promotional initiatives are needed and an appropriate informative system still has to be put in place at least in the Programme Area in order to allow social enterprises to be "educated" and properly informed about finance and its role in contributing to enterprise development and strategies Financial Governance mechanisms: the financial industry should be involved when it goes to prepare, design and implement financial mechanisms and tools at local, regional and National level which are targeted to social enterprises Financial instruments and incentives should be rationalized at all levels (fund of funds)

Serbia

Social enterprises do not have clear and stable system of financing, the debate is mostly focused on identifying all possible solutions. One level is possible reform of public procurement which should be more opened for SEs.

The involvement of business sector in a more strict cooperation with SEs is also under discussion: on one hand to tackle CSR activities toward SEs and on the other to involve SEs in chain of procurement of goods and services of profit companies.

Donations are also still a hot topic, and how to make them more available for SEs. Social enterprises are trying to discover new ways of financing, but at this stage are mostly dependent on donations (domestic and international donors).

Main issues	How to mind the gap: proposal
There is no substitute for a comprehensive framework that supports the financial needs of social entrepreneurs during start-up, development and growth of their social enterprises. Social entrepreneurship attempts to generate a spirit	At national level: International Donors and Some Distinctive Representatives Of Banking/Profit Sector have been supporting SE Sector in line with their CSR strategies. This can serve as good example to others and the replication of similar actions could occur. Also a simplification of public procurement

of self-help amongst disadvantaged individuals and communities. By definition these are not well resourced communities. In general the banking system for SMEs (including social enterprise) is conservative and risk averse and the unrecognised legal form of SEs in Serbia makes team huge risk for investment. Micro-finance is severely constrained and over-regulated by international standards due to its overdependence on the banks. Similarly credit unions, member-based financial co-operatives, are not allowed in Serbia. Procedures for public procurement are still too complicated and rigid to allow participation of social enterprises and, on the other side, profit companies are not eager to cooperate with SEs.	procedures is needed. Institutional framework should be improved by: establishing single body, that will be responsible for the improvement of SE sector and that will coordinate various stakeholders at central and local levels; developing further mechanisms for support through establishment of Social Inclusion Fund; providing more favourable taxation environment. Coherent policies for the development of SE should be provided by adopting Strategy for development of SE with clear objectives, targets, means and indicators for monitoring the progress. Good practices of support to SE and good examples of social enterprises should be promoted Entrepreneurial capacities of managers and employed persons in the SE sector needs to be improved At the local level: sensibilisation and raising capacities of representatives of local municipalities and local business on existence and importance of SE sector

Slovenia

The main focus is on how the private investors could be involved in social enterprises. In fact the trend is currently on promotion of importance of social entrepreneurship and involvement of private companies in this sector.

The public funds - Ministry of Labour, family, social affairs and equal opportunities so far published calls in 2009 and 2012 for financing the projects regarding the social economy financed from the European Social Found.

The social enterprises are increasingly looking for private investors and opportunities for competition on the market.

Main issues	**How to mind the gap: proposal**
The main issue is that the potential investors do not finance social enterprises as they do not recognize the business opportunities. It will take time to change	On July 2013 the Slovenian governance has adopted the Strategy for development of social entrepreneurship 2013-2016 and in 2011 established

the general thinking. It is still more comfortable to start the classical company, especially from the point of view of profit sharing between individuals, than to start the social business where the profit must be exclusively intended to business. The documents and laws regarding social entrepreneurship are still under the process of preparation so this is one of the biggest weaknesses of all for the territory of Slovenia. The social entrepreneurship has still the negative connotation because of the past system which has been too focused in the social - with no emphasis on market economy	the Council for Social Entrepreneurship, which is responsible for the policy development of social entrepreneurship in Slovenia, in cooperation with the ministries, government departments, local authorities, social partners and civil society organizations. At national and regional levels, there is the necessity to promote the social entrepreneurship and present it as the new trend of economy. At national level the government must set the incentives to encourage the process of social entrepreneurship and the financing the social enterprises. At regional level, some municipalities are already preparing the specific financial measures for social enterprises for the next financing period (2015).