ASSESSMENT OF STATE OF THE ART OF FINANCIAL INSTRUMENTS ADDRESSED TO ENTERPRISES/INITIATIVES PRODUCING RELEVANT **SOCIAL IMPACT**

2018

Piedmont
Lombardy
Andalusia
Valencia

European Commission

IFISE Innovative Financial Instruments in support to the Social Economy

JUNTA DE ANDALUCIA
Agencia de Innovación y Desarrollo de Andalucía IDEA
CONSEJERÍA DE ECONOMÍA, CONOCIMIENTO, EMPRESAS Y UNIVERSIDAD

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EXECUTIVE SUMMARY

The first chapter draws the conceptual framework of the social sector in Europe with special focus on Spain and Italy. The differences between the definitions of Legal Social Enterprise, in Spain and Italy, and the definition called 'de facto' or operational that is established by the EU and which is assumed for this document. According to this definition A SOCIAL ENTERPRISE is an operator in the social economy whose main objective is to have a social impact rather than make a profit for the owners of shareholders. It works by providing goods and services for the market in an entrepreneurial fashion and uses its profits primarily to achieve social objectives. It is managed in an open and responsible manner and, in particular, involves employees, consumers and stakeholders affected by its commercial activities. This difference in definition affects the spectrum of Social Enterprises, especially in Spain, whose Social economy is solely recognized by legal form, while in Italy the spectrum of social enterprises is assimilated to the European one. This discrepancy between legally recognized social enterprises and the 'de-facto' is the principal reason that many of 'de-facto' social enterprises are not officially recognized and operate 'below the radar'. The sectors of activity and the goals pursued by social enterprises are very diverse, being the most prevalent those focused on social care, labour integration and environmental services. The business models and the primary driver of the social enterprise (impact first instead of financial first) to develop these activities are not compatible with traditional investment principles and rules as required by financial agents acting in the 'normal economy'.

Finally, in this first chapter the main drivers and modes of creation of the activity of a social enterprise are shown, which come from three focuses, one due to citizen leadership, commercialization of a traditional non-profit organization and a restructuring of the public sector.

The second chapter describes the ecosystem of social enterprises, with a focus on Spain and Italy, addressing the legal framework, support schemes and, finally, an overview of key actors. The relevant financial players and other key players in each region are identified and compared. This allows drawing lessons from best practices in each country. Related to legal framework it has been compared Spain and Italy with UK which has the most developed regulations on Social Sector so in Spain, many de facto social enterprises act below the radar, and in consequence cannot benefit from incentives (taxes etc.) for social enterprises. On the other side, many cooperatives do enjoy benefits, having no social impact.

The main support schemes for social enterprises are summarized (taxes, grants, financial instruments, awareness, markings, physical infrastructure, investment readiness and networks) as they have implications for the development of new financial instruments.

Public financial instruments are still in an early stage of development, with low innovation and sophistication levels. Spain does not have a formal identification scheme. In Italy there are no special labels or brands, but there is strong promotion of social start-ups. Financial instruments are more developed and there is better cooperation with public authorities. Finally, compared with Spain, the Italian "social enterprise" category creates a high level of awareness.

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With respect to the key players for the support of the social economy, a differentiation between "financial suppliers" (distinguishing between different types of financial intermediaries), and "other key players" (non-financial agents with influence or impact on the social sector) is made. In Spain, the decentralization of the state administration at the policy level, involves different actors which adapt their goals and rules to local problems and interests. Although there are some national organizations, like CEPES, many of the key actors promoted by the government are rooted in an Autonomous Community (region). Other key actors with a private bias are the foundations created by the savings banks. But they have seen their influence shrink considerably during the financial crisis. In Italy, public policy is centralized and many of the key actors have a national scope. Social cooperatives have an important role because of their powerful networks focused at the local level.

The third chapter tackles the key issue of measuring impact, which is essential to attract social investors. Measuring the impact is essential to know the social results of the activities of social enterprises. It is indispensable to provide this info to social investors, so they can assess the impact of their investments. Measuring is a way of learning. The difficulty is to transform it into continuous improvement of the organization. Measurement drives behaviour: "you get what you measure". The objective of impact measurement is the management & control of the process of generating social impact, so as to optimize it in relation to its costs. To be viable, the social impact must be linked to economic performance. Donors and social impact investors want the funds they provide well spent: organizations must not only "do good", but they "do it well". The measurement of social impact is based on a widely accepted flow system, variously known as the Impact Value Chain, Change Theory or Logical Model. The Impact Value Chain model is explained in detail as it connects inputs and activities (in the organizations' planned work) with outputs, outcomes and social impact (in the organizations intended results). All methods follow five steps: a) Planning / setting objectives, b) Engaging & analysing stakeholders, c) Setting relevant measures, d) Measuring, validating and valuing y e) Reporting, learning and improvement. Not one of the many measuring methods responds 100% to the diverse situations faced when measuring the impact of social initiatives. All solutions require a tailor-made approach.

The chapter four makes an analysis of the needs of the social enterprises, specially financial ones, starting with a presentation of the main traits of these social enterprise in terms of size, structure, assets, profitability, human resources, etc and their implications in access to finance which is a constant problem for the development of social enterprises. The analysis of the main weaknesses of social enterprises shows a significant interdependence among them, both internal as external, making a vicious circle very difficult to overcome.

As external weaknesses must be indicated: national rules imposing limitations on their activity and financing, high reliance on the public sector, low recognition of positive externalities. The principal internal weaknesses are: lack of commercial orientation and entrepreneurial spirit, lack of managerial and professional skills, lack of an attractive and scalable business model. Having presented the particular characteristics of social enterprises and how they affect their access to financing, it is necessary to evaluate the different needs that companies in the social sector require to address the weaknesses and challenges

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they face. The approach that has been used to determine the necessary measures starts from the fact that these factors are intimately imbricated.

A decision tree for access to finance is presented in order to select the most suitable kind of instrument for a social enterprise according its characteristics; these instruments can be included within three categories: Philanthropy, Guarantee or Loan instruments, equity/quasi-equity/hybrid instruments. According to the different types of Investors and investments needed for the Social Sector, different matchings have been developed in order to clarify the relationships between type of financial instruments, enterprises-cycle life and type of business model. These matchings in combination with the Cristina López-Cózara and Tiziana Priedeb's report: "Identificación de los Principales Fuentes de Financiación Empleadas por la Empresa Social en la Actualidad" (Identification of the Main Sources of Financing Employed by Social Enterprise in the Present), which uses the Delphi Method to measure how social entrepreneurs evaluate the various financial mechanisms available, provide the following conclusions: Most common sources of finance: equity, prizes and 3Fs (Family, Friends and Fools); Most difficult sources: grants, loans, venture capital and crowdfunding; usability is inversely proportional to difficulty of implementation, the most recommended financing methods are: self-financing, 3Fs crowdfunding and prizes; regardless of the company lifecycle (seed / start up and scaling / expansion) "alternative" and "equity / quasi-equity" instruments are evaluated as the most desired instruments. These instruments need to be developed further.

The fifth chapter makes an intensive analysis of the supply side of financial instruments addressed to the social enterprise and presents their state of the art. For this purpose, more than 50 concrete instruments within the EU have been analysed (different aspects such as the public or private nature of the issuer, the types of intermediaries, the public or private origin of the funds, size, target group etc.). In relation to Social Impact Bonds (SIBs) data from more than 130 cases worldwide have been analysed.

SIBs are the fastest growing financial instruments in terms of social impact investing in recent years. First used in the UK and other anglo-saxon countries, they have spread quickly to a large number of countries, in and outside the European Union. It is a convenient instrument for public administrations, since they allow for payments tied to positive results, and in proportion to the savings in social spending. While the social impact investment market has grown significantly, drawing increasing attention, it is still in the early stages of development and represents only a small share of the global capital markets.

The success of social impact investing instruments depends on the correct composition / configuration of the different stakeholders (investors, investees, intermediaries), all with varying interests and motivations as well as its adaption to the framework conditions. There are many players within the ecosystem. This ecosystem is formed by the following players: public administrations, financial entities (commercial banks and ethical banks), funds and risk capital managers (philanthropic funds, patient capital, managers specializing in social finance), foundations, consultants specializing in the social field; accelerators and incubators and social enterprises (limited companies, cooperatives, mutual societies, etc.). It can be said that the ecosystem

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in Italy is more developed than in Spain, but far behind the vanguard UK.

For the means of the analysis of the state of the art of financial instruments the following types of instruments have been differentiated: Loans, Equity/Quasi-equity, Social Impact Bonds (and other payment for success instruments), Guarantee Schemes, Microcredits and Crowdfunding. Both their suitability to contribute financially to social projects and the feasibility of their implementation have been assessed. The survey also analysed the stage of development, implementation capability of regional agencies, innovation level of the FI, origin of resources. In general, there are few innovative practices with a specific incidence in social enterprises. Normally they are standard financial instruments but socially labelled. The low penetration of social venture capital initiatives in Spain and Italy is mainly due to a shortage of high quality investment opportunities.

The sixth and final chapter gathers the main conclusions of the document and presents some additional considerations. The principal ones would be:

- Social Impact Investing is increasingly becoming mainstream. Investors are forcing a “double bottom line approach” (financial returns + social returns) in their investment decisions. For social impact investors, the lack of capacity building in social enterprises (particularly in early stages) is the key obstacle.

- There is significant potential in developing effective financial instruments for the social sector. But countries with a clear legal definition of social enterprise (SEs) tend to have a stronger social sector and will enjoy an advantage.

- Social enterprises need to focus on their main sectors of activity -social care, healthcare, education, worker integration social enterprises- and social targets -the unemployed, people with disabilities, minority ethnics groups, those at risk of social exclusion, etc.- to attract investment/finance.

- An effective Financial Instrument for social enterprises must adapt to different types of targeted organisations. A “one size fits all” instrument will not do.

- To attract capital for social impact investment measurement is key, as it drives behaviour: “you get what you measure”

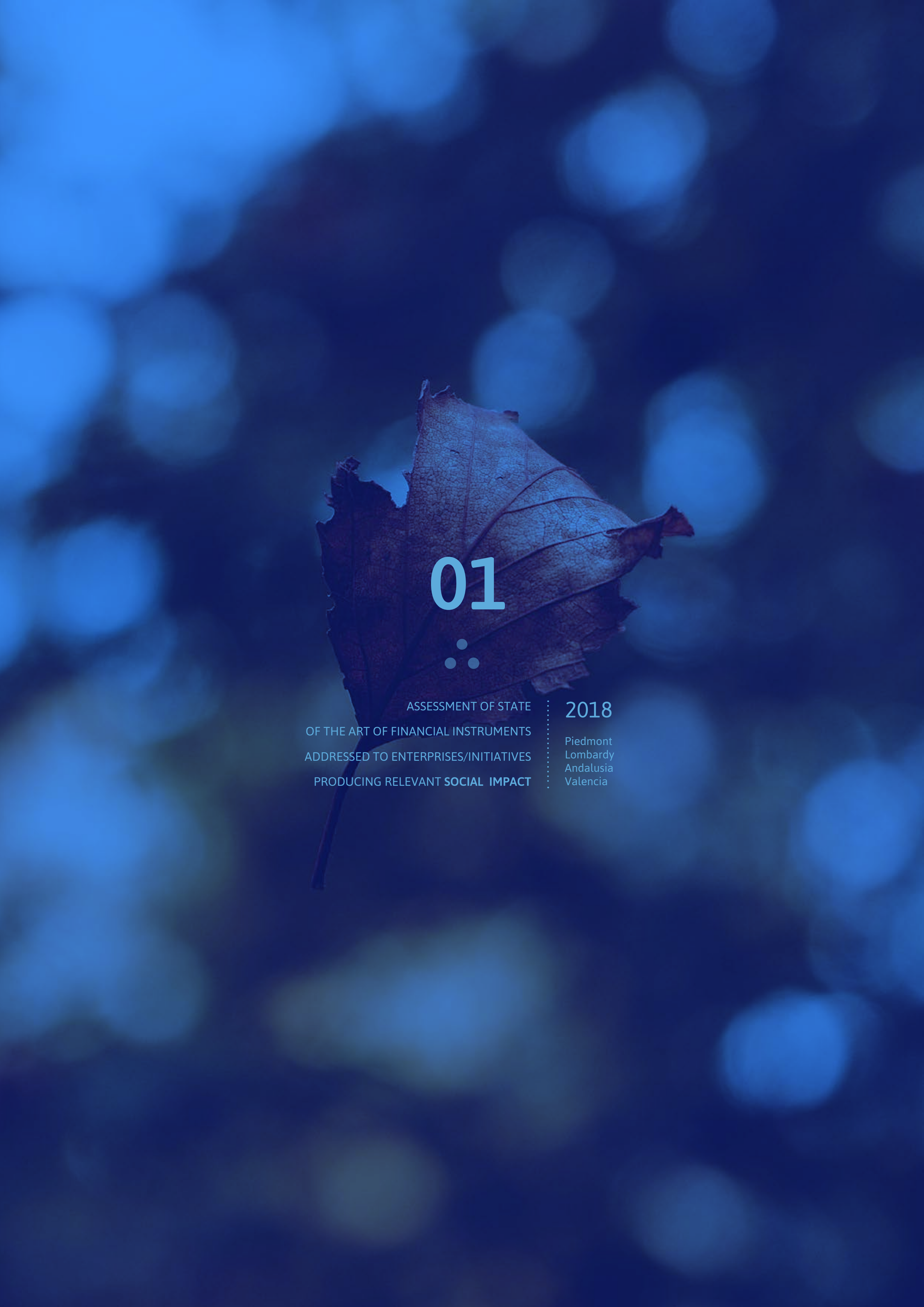
- Access to finance during the whole company lifecycle is the key constraint for the development of social enterprises. Their reliance on the public sector raises questions of sustainability. Mainstream banking solutions provide no adequate response, for three reasons:

    - Risk: perception of high risk with no collateral.

    - Return: high transaction costs for expected below-market returns.

    - Impact: positive externalities are not taken into account.

- Instruments targeting early stages need to combine financing with capacity building and post investment support.



01

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01. SOCIAL ENTERPRISE: DEFINITIONS AND CONCEPTS

ⓐ **Definition: two understandings of social enterprise (narrow and broad)**

ⓑ **Spectrum of social enterprises**

ⓒ **Main traits, business models and income streams**

ⓓ **Main drivers and modes of creation of *social enterprise* activity**

INTRODUCTION

This first chapter draws the conceptual map of the social sector in Europe. Firstly, we propose a common language of basic concepts and definitions.

There is a legal definition of *social enterprise* and a *de-facto* definition, used by the EU, based on three key dimensions: *social* ends, *economic* means and *methods* of governance.

The defining traits and business models of *social enterprises* are quite diverse. They vary significantly, in light of the relevance of the social area targeted, the impact achieved and the financial resources generated. Within such a broad spectrum we can find:

A) ***Special purpose organizations***, such as charities focussed on impact only.

B) ***Revenue generating social enterprises*** with a clear prevalence of impact over income.

C) ***Socially driven businesses***.

D) ***Traditional businesses*** with various levels of commitment to social impact or social responsibility.

Finally, taking into consideration all these dimensions, we address the different business models. We classify them based on the provenance of their revenue streams:

- Revenue from ***market activities***.
- Revenue from ***public contracts***.
- Revenue from ***private or public donors***, in the form of subsidies or public grants, donations or fees.

ⓐ Definition of social enterprise: narrow and broad understanding

Social enterprise is a concept with different meanings in different environments. In order to map *social enterprise activity*, with its various eco-systems, and to measure it, it is critical to understand just what social enterprise is –and what it is not–.

To attain a clear concept of *social sector enterprises*, we need to compare the hard definition used by Spanish law *(5/2011 29th March of Social Economy (legal definition)* and Italian law (*Law no. 155/2006*), with the soft definition used by the European Union *(COM (2011) 682; Brussels, 25.10.2011)*.

EUROPEAN DEFINITION

The European Commission (EC) uses the term *"social enterprise"* in the *COM (2011) 682 Brussels 25.10.2011* to cover the following types of businesses:

a) Those for which the *corporate mission* of furthering the common good –often involving a high level of *social innovation*– is the reason for the commercial activity.

b) Those whose profits are mostly reinvested with a view to achieving this socially oriented *corporate mission*.

c) Those whose formal organisation or ownership system reflects their social corporate mission, by involving democratic or participatory principles which focus on social justice in the firm itself.

The SBI *(Social Business Initiative of the European* Commission) definition incorporates the three key dimensions of a *social enterprise*:

Figure 01: ***The three dimensions of social enterprises, according to the European Commission.***

Entrepreneurial Dimension	Engagement in continuous economic activity, which distinguishes *social enterprises* from traditional non profit organisations / social economy entities (pursuing a social aim and generating some form of self financing, but not necessarily engaged in regular commercial activity).
Social Dimension	A primary and explicit social purpose, chich distinguishes *social enterprises* from mainstream (for profit) enterprises.
Entrepreneurial Dimension	Existence of mechanisms to "*lock in*" the social goals of the organisation. The governance dimension, thus, distinguishes *social enterprises* even more sharply from mainstream enterprises and traditional non profit organisations / social economy entities.

A *SOCIAL ENTERPRISE* is an operator in the social economy whose main objective is to have a social impact rather than make a profit for their owners or shareholders. It operates by providing goods and services for the market in an entrepreneurial fashion, and uses its profits primarity to achieve social objectives. It is managed in an open and responsible manner and, in particular, involves employers, consumers and stakeholders affected by its commercial activities.

Source: Own elaboration adapted from European Commission.

SPANISH DEFINITION

In Spain, there is no formal definition of what constitutes a *"social enterprise"*. The use of terms such as *"social enterprises"* and *"social entrepreneurship"* in public discourse, policy pronouncements, in the media and in society at large is quite rare.

In Spain, the concept of *"social economy"* – according to Law 5/2011– designates a set of economic and entrepreneurial activities carried out in the private sector by entities that pursue the *collective interest* of their members –economic interest, social interest or both– in accordance with the following principles:

- **Human purposes** –individual and social–have primacy over the *economic* aims of capital.
- **Sharing of rewards**: profits obtained from its economic activity shall be distributed mainly according to the work contributed or the service/activity performed by its partners.
- **Promotion of solidarity** both internally and with society as a whole.
- **Independence** *vis-a-vis* public authorities.

The type of entities that can be considered as being part of the social economy are "cooperatives, mutual societies, foundations and associations engaged in an economic activity, employee-owned enterprises, work integration enterprises, sheltered employment centres, fishermen's associations, agricultural processing companies and unique entities created under specific rules that are governed by the principles set forth in the previous article are part of the social economy".

ITALIAN DEFINITION

The legal category of *"social enterprise"* was introduced in 2005 with the adoption of the *Law on Social Enterprises* (Law no. 155/2006). Its purpose was to promote more diversity in the production of *social utility* goods and services, and to broaden the sectors of activity involved. The law does not create a new legal form or a new type of organisation, but rather allows an existing organisation to be legally recognised as a *"social enterprise"* regardless of its legal form, provided it complies with the following criteria:

- It must be a private legal entity.
- It has to engage in regular production and exchange of goods and services having *"social utility"*.
- It ought to seek *public benefits* rather than private profits.
- It can make a profit, but it cannot distribute it to its members or owners. Profits must be *reinvested* to further its main statutory goal, or to increase its assets with a view to that ultimate goal.

Currently an overall change in the regulation is undergoing, through the so-called "Reform of the Third Sector Law" that will be presumably operational from 2019 and will introduce several changes (*see below some insights on it*).

DE-FACTO OR OPERATIONAL DEFINITION OF SOCIAL ENTERPRISE

To summarize the European or *operational* concept of *social enterprise*: it is an operator in the social economy whose main objective is social impact rather than profit. It provides goods and services for the market in an entrepreneurial/innovative fashion, but uses its profits to achieve social goals. It is managed in an open and responsible manner, involving employees, consumers and stakeholders affected by its commercial activities.

For the purposes of this project we shall use the *operational concept*, as it reflects all the possibilities contemplated by the EC, and is directly linked to the social objectives, independently of the legal form of the enterprise.

- ◊ The de-facto definition arises because of the need to adapt to the diverse realities of the social sector.
- ◊ Those countries with a clear definition of social enterprise have a stronger social sector.

ⓑ Spectrum of social enterprises.

I. **In Italy the spectrum of *social enterprises* is divided between legal and *de facto*** based on the national registers (held by Ministries, Revenue Agency, National Bodies, Regions, Provinces, Prefectures and Chambers of Commerce), the two categories are composed by the following subcategories:

  1. **Legally Recognised Social Enterprise:**
     - Social Cooperatives;
     - Social Enterprises Ex Lege (according to italian legislation).
  2. **De-facto Social Enterprises:**
     - Associations;
     - Foundations;
     - Cooperatives (excluding social cooperatives) engaged in the production or exchange of goods and services of "social interest";
     - Profit oriented enterprises engaged in the production or exchange of goods and services of "social interest".

II. **In Spain there is a wide spectrum of organisations** with different legal forms, degrees of market orientation and financial viability, as well as different social missions. The following are different types of organisation regarded as *social economy* in Spain:

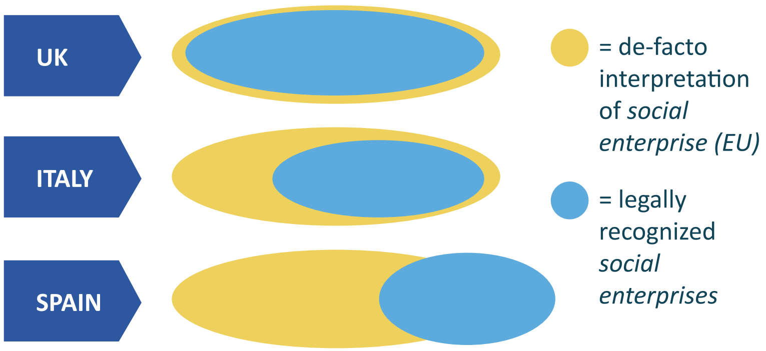
  1. **Cooperatives**: The *Law 27/1999* defines *social initiative cooperatives* as *"those cooperatives that, being non-profit and independent, engage mainly in certain sectors and activities with a clear social impact"*.
  2. **Mutual insurance:** not-for-profit private insurance entities.
  3. **Foundations and associations engaged in economic activity:** foundations must have as their mission pursuing a common general interest and not an individual one.
  4. **Worker-owned companies:** *"corporations or companies of limited responsibility, where most of the capital belongs to the workers"* (Article 1 of Law 4/1997).
  5. **Work integration social enterprises (WISE):** usually set up as foundations or associations.

III. **Europe's spectrum of social enterprises.** In order to identify *"EU defined social enterpri-*

ses", the main characteristics of the variety of organisations currently believed to be *social enterprises* were mapped against the background of the core criteria of the EU operational definition. When analysing the European spectrum by using this map of social enterprises and their eco-systems in Europe, what we find is the following:

1. **Legally recognised social enterprises:** those having a distinct legal identity in the country concerned (either through a legal form exclusively designed for *social enterprises* or a definite *social enterprise* legal status).
2. **De-facto social enterprises:** beyond the legally recognised social enterprises, these are entities which meeting in full the criteria laid out by the EU definition (and being, therefore, *de-facto* social enterprises), span across a wide variety of organisational and legal forms –such as WISE, cooperatives, associations, mainstream enterprises, etc.–.

Figure 02: ***British, Italian and Spanish maps of social enterprises: how de facto and legal interpretations overlap.***



Source: Own elaboration.

Discrepancy between legally recognized social enterprises and de-facto *social enterprises* with high incidence in Spain (and less in Italy).

- many "*de-facto*" *social enterprises* operate "below the radar" because they are not legally recognized as such.
- potential impact on the development and effectiveness of FI for the social sector.
- In Spain, some legally recognized enterprises, mutual and some cooperatives, have activities which cannot cosider as social according to *de-facto* definition.

In order to ensure a consistent approach for the development of FI the IFISE consortium follows a "*de-facto*" definition of *social enterprises*.

The Spectrum of Social Enterprises in Europe

- The Italian spectrum of *social enterprises* is very similar to the European one.
- The Spanish spectrum merely displays the most common legal forms usually regarded as *social economy*.
- Not a single one of these varieties of social enterprise is particularly oriented towards developing specific financial instruments aimed at enhancing the resources of the *social economy*.
- The number of *de-facto social enterprises* that operate *"bellow the radar"* depends on the legal recognition of such activity as *"social"*.
- There is a significant potential impact in developing effective financial instruments (FI) for the social sector.
- To ensure a consistent approach for the development of FIs, the IFISE consortium follows a *"de-facto"* definition of *social enterprises*.

c) Sectors of activity, targets, income streams and business models

The social sector's financial needs are catered to in a variety of ways. Our purpose is to help develop new financial instruments (FI) to help this sector garner the resources it needs to grow and achieve its goals. To do that we need first to: a) draw a clear map of the sectors of activity in which it operates; b) identify the target groups towards which it aims its efforts; c) ascertain the income streams from which they draw their resources; and d) explain their business models.

Examining the situation of *social enterprises* in Italy, Spain, and in Europe generally, we first need to track their sectors of activity, targets groups and sources of income:

I.- Sectors of activity in Italy, Spain and the rest of Europe

In Italy, pointing out just on the social cooperatives, the activities undertaken by the largest proportion are centered around the provision of the following social services ("Social enterprises and their eco-systems Updated country report: Italy" 2016.):

- **Social care and civil protection:** 40%
- **Economic development and social cohesion** (this includes type B of social cooperatives or worker integration social cooperatives): 32%
- **Health**: 11%
- **Education and research:** 8%

These activities include:

- **Socio-medical home care.**
- **Educational activities** and rehabilitation.
- **Social and cultural activities.**
- Management of ***kindergartens* and childcare services**.
- Management of **community housing** and family homes.
- Management of **centres and residences for elderly people**.
- Training and mentoring for the **employment of the disadvantaged**.
- Creation and implementation of projects aimed at **the most marginalized people** (at risk of social exclusion).

In Spain, *social enterprises* are active in many different economic sectors. We estimate that, at present, roughly half (50%) of *all social enterprises* are active in the service sector, carrying activities mainly in education; one fifth (some 20%) works in agriculture; and the rest are divided between the manufacturing and the construction sectors. The main activities, by legal type, are:

- Social Care Sector: **schools, day/night centres, labour integration.**
- Employment Centres: **cleaning services, gardening.**
- Work Integration Social Enterprises (WISE): **services, textile industry.**
- Foundations: **industrial laundry.**

In Europe, the key starting point to understand any description of the sectors of activity of *social enterprises*, is this key distinction: identifying and distinguishing the *social mission* they are undertaking and the *social impact* they seek through their activities in certain areas/fields, on the one hand, and the *people* they target, on the other hand.

Given this starting point in understanding *social enterprise* activity (based upon the distinction between mission/goals focusing on *activities* and *people* targeted), we find that in Europe it is geared towards:

- Social and economic integration of the **disadvantaged and excluded.**
- Social services of general interest: such as **care for the elderly** and for **people with disabilities, child care; employment and training services; social housing; health care and medical services.**
- Other social and community services: such as **counselling, youth outreach, temporary housing for the homeless, rehabilitation of ex-convicts, micro finance for the self-employed**, etc.
- Public services: such as **maintenance of public spaces, public transport, garbage collection**, etc.
- Environmental projects: **reducing emissions and waste, recycling, renewable energy projects**, etc.
- **Cultural activities, tourism, sport and other recreational amenities.**
- **Solidarity with developing countries:** e.g. through the promotion of *"fair trade"*.

Sectors of activity

- The activities and goals are very diverse, with the most prevalent ones centering around social care, work integration and environmental services.
- The business model most common in developing these activities does not fit well with the current investment principles and rules, as required by the key actors that design and finance normal economic activities.
- The main reason for this is the difficulty of these social enterprises to compete according to both market rules and their non-profit principles.

II.- Target Groups

Which are the target groups, which according to this concept are defined as the final collectives that *social enterprises* work for?

30% of *social cooperatives* operate with the goal of creating employment for **disadvantaged groups: people with physical or mental disabilities, present or former psychiatric patients, drug addicts, alcoholics, young people from troubled families, and convicts on probation (subject to alternatives to imprisonment).**

Many *social enterprises* target the entire population, as customers of goods and services. However, various specific disadvantaged groups are targeted by *social enterprises* focusing on *work integration*: **people with disabilities, drug addicts, people in risk of social exclusion, convicts, members of disadvantaged or dysfunctional families, women victims of gender violence and their children**, etc.

There is a strong commonality of target groups of *social enterprises* across European countries. But comprehensive and reliable data on them is lacking. As is to be expected, target groups closely reflect the sectors of activity chosen by European *social enterprises*:

- The provision of training, skills and job opportunities by WISE (*work Integration social enterprises*) is targeted at those "*disadvantaged in the labour market*". There is a strong commonality in the types of groups targeted by this activity across European nations: women, people with disabilities, minority ethnic groups, migrants, ex-convicts, etc.
- Addressing the social, economic and/or environmental needs of a particular local neighbourhood or community.
- More broadly, *social enterprises* seek to explicitly tackle social issues through the substantial provision of basic social services of general interest. Provision is targeted not only at the most vulnerable groups within the population, but also to all groups in need in society.
- The increased market orientation of *social enterprises* –with their growing expansion into the supply of consumer goods and services- should also be seen as introducing new target groups among consumers and businesses in general.

Targets Groups

- Focusing on the main sectors (social care, healthcare, education, WISE) and social targets (the unemployed, people with disabilities, minority ethnics groups, those at risk of social exclusion, etc.), there are two ways to develop the financial instruments (FI) that best fit their needs:
  a) Using conventional instruments to finance normal societal legal forms.
  b) Developing specific financial instruments that enhance all possible social goals and vehicles of social action, such as the Social Impact Bond (SIB).

III.- Sources of income: the impact of the economic crisis in Europe

The client base and sources of income of *social enterprises* have become more diversified over time. In 2011, revenues from public contracts represented 65% of the total income of *social cooperatives*; and revenues from the sales of goods and services to private clients represented 28% of the total. Clearly, the public sector represents the main engine for the development of *social enterprises.*

However, as explained by some of the *social enterprises* surveyed, this dependence on public resources is currently affecting their growth. For two reasons: a) the decreasing availability of funds in crucial areas such as social welfare; and b) the financial burden of significant delays in payments by public administrations at all levels. The recent economic crisis (2010-2013) and slow recovery in Europe, and the consequent funding cuts and delays in payments by public administrations, have particularly affected *social cooperatives*.

These organisations are facing mounting difficulties in finding stable sources of revenue. Some of the *social cooperatives* consulted faced acute financial problems. In many cases, delays in payments from public administrations meant these organisations could not pay their employees on time.

Many *social cooperatives* responded to these challenges by focussing on growth, improved internal efficiency and expansion to new sectors (Venturi and Zandonai, 2012b). For example, some have diversified its client base by providing services to private companies, in order to reduce their dependence on the public sector.

In Spain, the spectrum of *social enterprises* is full of *cooperatives*. For this reason, the main source of income of Spanish *social enterprises* is their commercial revenues.

However, as the table below clearly shows, there are other sources of income, such as membership fees, grants, donations or rental income. *Crowdfunding* has also become an important source of funding for social entrepreneurs, associations and foundations that used to be largely dependent on public money and members' fees:

Figure 03: ***Sources in dependence of legal status.***

SOURCE OF INCOMES		
LEGAL FORM	**MAIN SOURCES**	**OTHER SOURCES**
Cooperatives	Trading Income	fees, grant, donations
Foundation/Associations	Grants and Donations	fees, grant, rentals
WISE	Trading Income	fees, grant, donations
Sheltered Employment Centres	Trading Income	fees, grant, donations

Source of incomes

Since the public sector is cutting back on the availability of resources, public and private organizations have to develop new ways to maintain and increase their social impact, by generating their own resources and reducing their dependency on government budgets.

IV.- Business models

In seeking to create a financial instrument that fits correctly the specific needs of its purported beneficiary, it is necessary to describe in detail the business models (BM) of these organizations. They are sketched in the following chart, which showcases the different levels of intensity of its *primary drivers* (from *"impact only"* to *"finance first"*).

Figure 04: ***Spectrum of social enterprises.***

Primary driver is to create social impact ← → **Primary driver is to create financial return**

Special Purpose Organisations								
Charities		Revenue Generating *Social Enterprises*			Socially Driven Businesses	Traditional Businesses		
Grants only: no commercial activity	Commercial revenue and grants	Potentially sustainable > 75 commercial revenue	Break even all income from commercial activity	Profitable, surplus reinvested	Profit distributing, socially driven	Corporate social responsibillity company	Company allocating percentage to charity	Mainstream market company
Impact only		Impact first				Finance first		

To make a financial instrument for *social enterprises* effective it has to be adapted to the nature/type of the targeted organisation and its specifics needs. A *"one fits all"* approach is not recommended.

Source: Own elaboration adapted from EVPA.

As the chart shows, business models (BMs) are defined by their *primary driver* (*social impact* or *financial impact*). Since commercial revenue is not the sole or major driver of a *social enterprise*, profitability becomes less important as a conventional metric of the BM. Moreover, the social mission of *social enterprises* places restrictions on the distribution of profits (surplus of revenues over costs) to ensure they are reinvested. It is, therefore, more pertinent to focus on revenue streams than on profitability *per se*.

While for-profit enterprises usually base their BMs on revenues generated through commercial activity, *social enterprises* rely on a range of revenue streams. The map of *social enterprises* and their eco-systems in Europe, shows how they finance their activities. *Social enterprises* typically adopt a *hybrid* business model. They derive their revenues from a combination of:

- **Market sources:** the sale of goods and servi-ces to the public or the private sector.
- **Non-market sources:** government subsidies and grants, private donations, non-monetary or in-kind contributions such as voluntary work, etc.

The prevalence of any of them defines the kind of *social enterprise* we are looking at. The other variable that explains the classification of a *social enterprise* as impact first or as finance first is the reinvestment of its profits.

The main revenue streams of *social enterprises* whose main goal is *social impact* can be described as follows:

- **Revenue derived from public contracts:** social enterprises contract with public administrations and agencies to receive fees for defined services (quasi-markets). The structure of these payments can be quite different, varying from direct payment to social security systems, voucher systems or indirect payment through third-party intermediaries.
- **Direct grants / subsidies:** these are provided to *social enterprises* by public administrations –e.g.: grants for a specific project-based activity, or employment subsidies often made available to WISE as 'compensation' for hiring people with disabilities (for the resulting productivity shortfall).
- **Market based revenue derived from private sources**: through the sale of goods and services to other businesses and final consumers.
- **Membership fees**, donations and sponsorship agreements.
- **Other forms of revenue:** income from renting assets (property), penalty payments, prize money or income from endowed assets.
- **Non-conventional forms of revenue** include also non-monetary *in-kind* donations (e.g.: old IT equipment, food or building material). On top of that, volunteer work has always been an important source of *in-kind* revenue.

High reliance of *social enterprises* on the public sector raise concerns about the predictability and long term sustainability of their business models.

The nature of the business models of *social enterprises*, and the origin of their income, go a long way in determining the types of financial instruments they use:

- **Funds assimilated to grants or subsidies** originating in the Corporate Social Responsibility (CSR) of the companies.
- **Short-term loans** guaranteed by anticipated public contracts, grants and subsidies.
- **Mortgage loans** with good LTV (Loan To Value)
- **Financing limited by the capacity of guarantors**.
- **Equity** and **participatory loans**.
- **Preferential loans** with low interest rates and long term maturities.
- ***Crowdfunding***.

Business Models

The business models are linked to:

- The *primary driver* of the enterprise: *impact only or financial first*.
- Sectors of activity: health, education, social protection, etc.
- Target groups: people with disabilities, neighbours, drug addicts, alcoholics, youth, etc.
- Sources of income: fees, loans, grants, equity, donations, commercial revenues.

d Main drivers and modes of creation of social enterprise activity

After analysing the business models and income streams of social enterprises, we proceed to describe how they are created and which are the main drivers of their activity. The new era of globalization and the general conditions of economic activity are important drivers that explain how social enterprises are created.

We describe the different ways in which social enterprises are created in the following chart:

Figure 05: ***How social enterprises are created.***

Citizen-led	• Citizen-driven mission organisations: groups of citizens set up organisations, often with few resources at their disposal, to address new needs and societal challenges. Predominant mode of creation. • Social start-ups: a social entrepreneur sees a market opportunity to trade a new good or service to meet a social aim or need. "*Anglo-saxon*" understanding of social entrepreneurship.
Marketisation of traditional non-profit organisation	• An existing organisation (voluntary organisation, charity, foundation) transforms itself into a social enteprise (because of increasing generation of commercial income) • An existing organisation (voluntary organisation, charity, foundation) set ups a commercial arm which is the social enterprise (due to legal restrictions for the existing organisation).
Public sector restructuring	• Public sector spin-out (opportunity entrepreneurship): management/staff recognise the greater potential for innovation and new investment sources through autonomy and independence, leading to a spin-out of the service. • Public sector spin-out (necessity entrepreneurship): drivers, such as shifting views on the role of the state in provision of services, new forms of procurement, social innovation and/or funding cuts, lead to an enforced "*decommissioning*" of an internal public service and an enforced (but possibly supported) "*spin-out*".

Public sector contracting and active labour market policies of the Government play an important role in stimulating the creation and development of *social enterprises*. The national framework conditions and ecosystem for *social enterprises* determine the modes of creation of *social enterprises.*

Source: Own elaboration adapted from "A map of social enterprises and their eco-systems in Europe", European Commission.

CONCLUSIONS

Definition and Concepts + Mapping the Social Sector in Europe

Transparency, standardization and objectivity are needed in the definition of *social enterprise* activity:

- Countries with a clear definition and identification of *social enterprise* have a stronger social sector.
- In Europe there is a *de-facto* definition because of the need to adapt to the realities of the market.
- The level of *standardization* is lower in Spain than in Italy.
- This gap creates a problem for developing financial instruments: it is not easy to fit the specific characteristics of each instrument to many *de-facto* social enterprises operating *“below the radar”*.
- An effective financial instrument for social enterprises must be adapted to the different types of targeted organisations. A “*one size fits all*” instrument is not adequate.

There are three types of countries according to their concept of *social enterprise:*

a) Countries where the legal development is fully equivalent to the *de-facto* definition, as in the UK. In these countries there is a higher development of financial instruments.
b) Countries where this process has advanced, but not fully yet. This is the case of Italy.
c) Countries, such as Spain, where convergence has not occurred, as there are still many *social enterprises* not recognized as such; and which, therefore, face more difficulties for their development.

High reliance of *social enterprises* on the public sector raises concerns about their long term sustainability. The business models are linked to the following dimensions:

- The primary driver of the enterprise: *impact only or financial first*
- Sectors of activity
- Target groups
- Sources of income

02

ASSESSMENT OF STATE
OF THE ART OF FINANCIAL INSTRUMENTS
ADDRESSED TO ENTERPRISES/INITIATIVES
PRODUCING RELEVANT **SOCIAL IMPACT**

2018

Piedmont
Lombardy
Andalusia
Valencia

02. THE ECOSYSTEM OF SOCIAL ENTERPRISES:

ⓐ **Legal framework**

ⓑ **Support schemes**

ⓒ **Overview of key actors**

INTRODUCTION

This chapter describes the main traits of *social enterprises* in the four regions, focusing on differences between Spain and Italy.

1.- **Legal framework:** we have focused our analysis on the *de-facto* definition –i.e., *social enterprises* with a social impact–, because in Europe the main legal solutions are:

- Adapting to the existing legal forms.
- Creating a unique legal status for *social enterprises*.
- Specific non-profit organizations (NPOs) that allow for economic activity.

We make a direct comparison between Spain and Italy, focusing on key regulations in both countries.

2.- **Support schemes:** we display the main support schemes for *social enterprises* (SE) –taxes, grants, financial instruments, awareness, markings, physical infrastructure, investment readiness and networks– as they have implications for the development of new financial instruments. We describe the most important support schemes, comparing those in Spain and Italy.

3.- **Overview of key actors:** we identify the relevant financial players and other key players in each region, and draw comparisons between them.

a) Legal framework

I.- Introduction

The general framework conditions in a country have a significant impact on the development of financial markets in general, and the *social impact investment* (SII) market in particular. The existence of a dynamic entrepreneurial financial market can facilitate the development of the *social impact investment* market (many people in SII were previously active in investment banking, private equity, venture capital / angel investment).

For the SII market to function well, the necessary legal frameworks and institutional structures, as well as streamlined regulations and requirements for investment, need to be in place. These include legal and civil frameworks for the creation and regulation of social organisations, as well as the availability of finance and market information for start-ups in this field. A number of countries have established legal requirements or civil codes for social ventures aiming to facilitate new social start-ups and reducing risks for both entrepreneurs and potential investors.

Regulations are a complex part of this picture. On the one hand, they may facilitate third party evaluation of social impact, and in turn help lower the risks for investors seeking social returns. On the other hand, they may create additional costs for the enterprises.

There are several legal and regulatory issues for institutional investors, including the new Solvency II (insurance companies) and Basel III (banks) requirements.

National tax laws have a huge influence in setting the conditions for *social impact investment*, primarily regarding the rules for donations to and investments in non-profits. In some countries, governments have provided support to social impact investors and social sector organisations through tax credits, guarantees or subsidies; or have, alternatively, supported investees through technical or procurement assistance.

II.- Regulatory environment in Europe

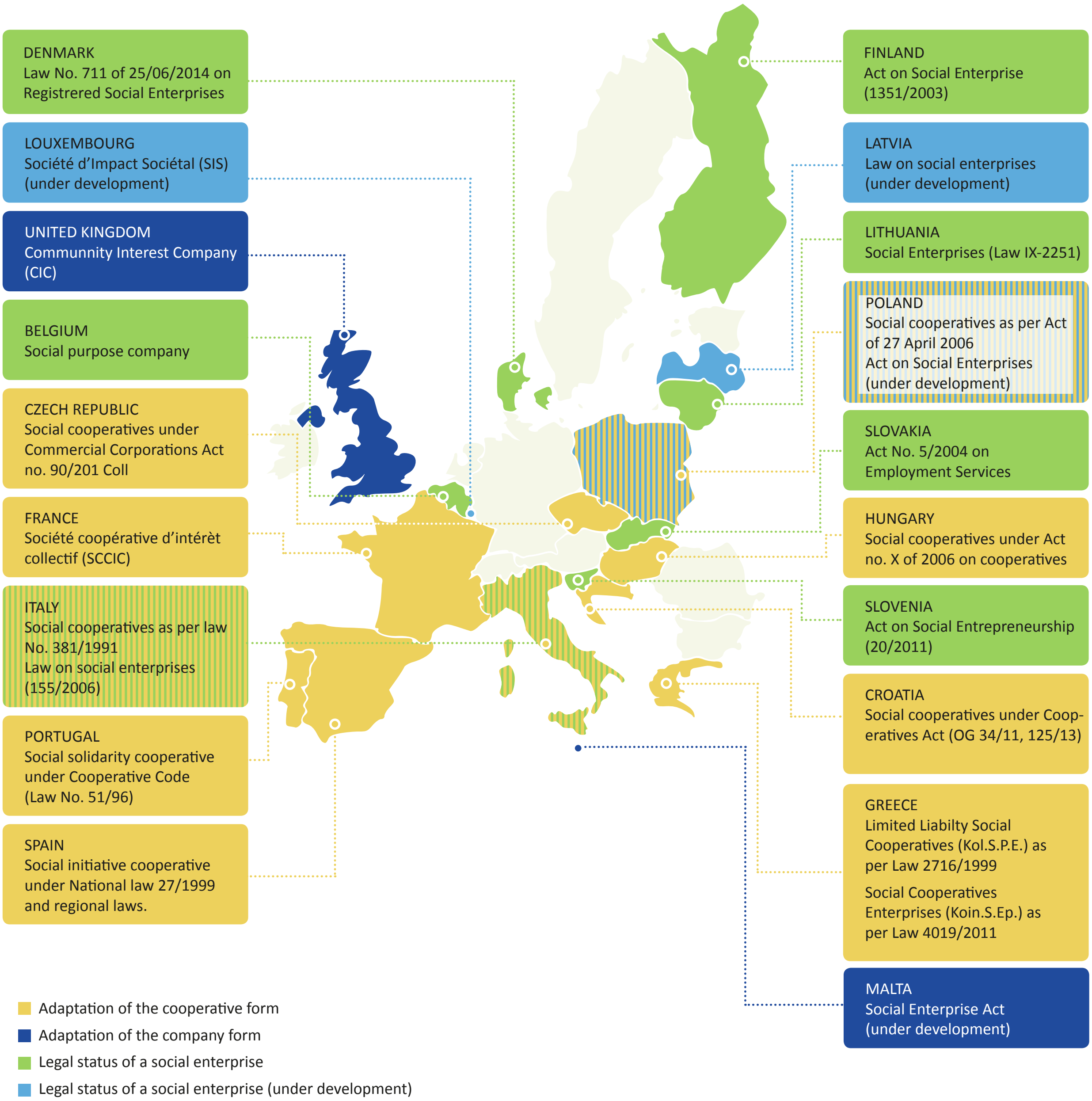
In Europe there are different ways to regulate *social enterprise* activities. Many countries have some form of legislation that recognizes them. There are, overall, three basic approaches in European regulations:

- **Adapting existing legal forms to cover the specific features of social enterprises:** some countries have created a new legal form adapting or tailoring existing ones like *cooperatives*.
- **Creating a unique legal status for social enterprises:** some countries have introduced transversal legal statuses that cut across various legal forms. They can be adopted by these various legal forms by meeting several pre-defined criteria.
- **Specific non profit organizations (NPOs) that allow for economic activity:** some countries have opted for this solution.

One option often debated is to consider all kinds of cooperatives as legal social enterprises, due to their consideration as such in many countries. Our decision has been to focus our project on social enterprises with a social impact and/or a social purpose, which differentiates them from normal cooperatives.

This is the map of the legal framework for the social sector in Europe:

Figure 06: ***The social sector and the law in Europe.***



Source: European Commission.

Some countries have adopted the solution of adapting existing legal forms for use by *social enterprises*, by satisfying the requirement of a "*community interest test*". These companies are characterised by:

- Restrictions on profit distribution
- Asset lock
- Furthering a social purpose
- Carrying an economic activity
- Filing annual reports

This type of companies is controlled by a public regulator. It seems to be a very flexible and accurate system for controlling the application of tax and financial schemes for a social purpose.

The information we have requested to the four national agencies is intended to find out if, at the regional (sub-national) level, there are 'specific' regulations or policies for the social economy that may influence the development of new financial instruments. These inquiries seek to dig deeper into the regional regulations –economic, social or commercial in nature– affecting the social sector.

III.- Comparing Spain and Italy

There is a big difference between the legal frameworks of the two countries:

- **In Spain**, the legal framework is focused on the type of entity, with no formal definition of *social enterprise* (SE). There are some criteria in the existing legislation to define a *social enterprise*, but there is no label or special legal category for SEs. This situation and the mosaic of policies resulting from the decentralised nature of the Spanish state, generates a lack of clear connection between SEs and the notion of social impact.

- **In Italy**, there are two ways to identify and focus on *social enterprises*:
    - There is a "*label*" or legal category of SE which all eligible organisations can obtain regardless of their ownership or organisational structure.
    - There are two types of legally recognized *social enterprises*:
        - ¤ *Social cooperatives*
        - ¤ *Social enterprises ex-lege*

Figure 07: ***The law and the social sector: Spain and Italy compared.***

Topic	Spain	Italy
Legal status of "social enterprise"	No formal definition or legal implementation of what constitutes a "social enterprise". Instead the concept of "social economy" prevails in public discourse. Concept of "social economy" in Spain according to Law 5/2011: • Primacy of the individual and of the social purpose over capital • Profits obtained from the economic activity shall be distributed mainly according to the work contributed	The Law 118/2005 and Leg. Decree 155/2006 introduces the principle of pluralism of organisational forms and does not consider legal form as a condition for eligibility as a social enterprise. The law introduces a legal category of 'social enterprise' and a more diverse range of activity sectors.The Law allows an organisation to be legally recognized as a social enterprise regardless of its legal form, provided it complies with the following criteria: • it is a private legal entity;

Topic	Spain	Italy
Legal status of "social enterprise"	• Promotion of solidarity internally and with society (commitment with local development, equal opportunities, social cohesion, the insertion of persons with the risk of social exclusion, the generation of stable and quality jobs, the conciliation of private, family and work life and sustainability) • Independence with regard to the public authorities The type of entities that can be considered as "institutionalised" social enterprises are "cooperatives, mutual societies, foundations and associations engaged in an economic activity, employee-owned enterprises, work integration enterprises, sheltered employment centres, fishermen's associations, agricultural processing companies. The decentralised nature of the Spanish state builds a diverse mosaic of policies and social economy movements at regional level.	• it engages in the regular production and exchange of goods and services having 'social utility' and seeking to achieve a public benefit purpose, rather than to generate a profit; • the enterprise can make profit but cannot distribute it to its members or owners (non-- distribution constraint). Key changes have recently been introduced by Law 106/2016 and Leg. Degree 112/2017 reforming the 'Third Sector' . This law provides a common framework for the sector with a view to overcoming its fragmentation from different perspectives, including fiscal ones. A social enterprise is defined as a 'private organisation that runs entrepreneurial activities for civic, solidarity and social utility purposes and allocates profits principally to achieve its corporate purpose by adopting responsible and transparent management modalities and favouring the largest possible participation of employees, users, and other stakeholders interested in its activities'. The law replaces the total distribution constraint with the remuneration caps foreseen for social cooperatives.
Consequences & Conclusions	Due to the lack of definition of "social enterprise" there is a great discrepancy between de-facto social enterprises and "institutionalised social enterprises" according to the "social economy law": • many de facto social enterprises act below the radar and statistically are not recognised (and cannot benefit from (fiscal) benefits) • any cooperative, independently whether or not can be considered as "social", benefits from the fiscal (and other) benefits.	The relaunch of the definition of social enterprises and the introduction of target-measures by the Law 106/2016 and Leg. Degree 112/2017 aims at attracting and facilitating external investors and supporting social enterprise development. The impact of the reform on both the 'Third Sector' and the social enterprise field will depend upon the implementation of subsequent decrees which will be adopted over the next years. Implementation decrees are also expected to improve the fiscal framework.

Source: Own elaboration adapted from Country Reports Spain, Italy, European Commission.

LEGAL FRAMEWORK

In Spain, many *de-facto social enterprises* act below the radar, as there is not a formal label for this kind of activity. These SEs cannot enjoy tax benefits. On the other side, many cooperatives do enjoy tax benefits, having no social impact or activity.

In Italy, *social cooperatives* have been a success. However, compared with the *social enterprises cooperatives* seem to have a lower social impact. For them the existing problems and limitations are higher than the benefits.

In the UK, regulations were changed to create a common space where the social ecosystem and the ecosystem of funds and investors for the social sector could converge and develop. The key is to find and eliminate the barriers to this development (e. g.: types of contracts).

ⓑ Support schemes

This section offers a broad picture of the current support schemes for the social economy in each country. Existing support schemes may have implications for the development of new financial instruments, as they might compete with, cannibalize or complement them.

The main support schemes for *social enterprises* are:

- **Tax exemptions and incentives:** there are very few countries with tax breaks specifically designed for *social enterprises*. The general pattern in European countries can be described as follows:
    - **Tax breaks may exist for certain forms of tax exempt non-profit organisations**: some deductible expenses, deductions on donations for donors, inheritance relief for donors or relief in property transactions taxation, relief on local taxes and relief on divestment incomes.
    - **Tax breaks may exist for work integration *social enterprises*** (WISE), if such concept exists: in this case, this type of enterprise receives some tax breaks, like partial reimbursement of wages, deductions or relief from social insurance contributions; and, in some cases, partial or complete exemption from corporation tax. WISE might also receive other forms of subsidies, such as subsidies for the adaptation of workplaces and subsidies for other relevant costs, like specialised job training, transport costs or the costs of adapted equipment (for workers with disabilities).
    - **Tax breaks may exist for the conduct of certain types of activity.**
    - **Otherwise, *social enterprises* are generally taxed according to their underlying legal form.**
    - **Tax system varies on a regional or local basis, in some countries.**

    These tax reliefs and breaks are generally focussed on de facto social enterprises. There is, however, a tax treatment for specific social enterprise legal forms. In a number of countries, legally recognised social enterprises are eligible for a range of tax exemptions:

    - Some forms of corporate tax relief
    - Tax relief on property transactions
    - Relief from local or municipal taxes

- **Grants, subsidies and donations:** there are many kinds of grants and subsidies for *social enterprises*. However, since the recent economic crisis, their continuity and sustainability has become unpredictable, as there have been substantial reductions in the funds available for these instruments. The main examples are:
    - Investment support
    - Employment subsidies
    - R&D grants
    - Start-up support
- **Communications and awareness raising:** dissemination of information, communication, advertising, public relations events and awards to support *social enterprises*.
- **Brands, labels and certification systems**: brands, labels and/or certification systems to

endorse *social enterprises* or promote products made by them.

- **Specialist business development:** the OECD recommends a system of support which includes both generic and tailored support to facilitate the start-up phase and the development of *social enterprises*.
- **Investment readiness:** projects that support incubators like:
  - **The Social Incubator Fund:** launched in 2012 and delivered by the Big Lottery Fund on behalf of the Office for Civil Society (OCS), provides grants to social incubators, part of which has to be invested in social ventures using non-grant financial structures. The aim of the scheme is to help establish a robust pipeline of start-up *social enterprises* by an increasing focus on incubation support, and by attracting new incubators into the market.
  - **The Investment and Contract Readiness Fund** is a £10 million fund, spread over 3 years, to help social businesses secure social investment and bid for public service contracts.
- **Physical infrastructure:** co-working spaces.
- **Collaboration and access to markets:** one of the key ways in which public policy can improve the market access of *social enterprises* is by making public procurement more open to the *social enterprise* sector via the inclusion of social clauses in procurement procedures. In parallel, publicly funded programmes could be designed to build understanding amongst local officials and capacity for *social enterprises* so that public procurement can be effectively used to support their development.
- **Networks, mutual support alliances and other special supports:** in many countries these networks play an important role as advisors, acting as advocates for the sector, negotiating contracts, etc. *Social enterprise* networks and umbrella organisations play an important role in terms of supporting social enterprises, particularly in countries where there are limited or no publicly funded support initiatives. Their role can be wide ranging: e.g., acting as a mutual support mechanism offering guidance and advice, exchanging good practices and interacting with public bodies in the design of specific public programmes.

  There are other special supports: particularly those involving awareness raising activities and social entrepreneurship education.

The following chart compares the various support schemes in place in Spain and Italy:

Figure 08: ***Comparison of support schemes for social economy of Spain and Italy.***

Support Scheme	Spain	Italy
Tax reliefs, reduced social security contributions and similar fiscal measures.	• Tax breaks and reduced social security contributions: limited to foundations,associations and social initiative cooperatives. • Reduced tax rates (and other fiscal benefits) for (any) cooperative and worker-owned companies.	• *Social enterprises*: no specific fiscal benefits. • *Social cooperatives*: benefits from favourable tax condition (reduced/ exemption of corporate, income tax, reduced VAT); *social cooperative* (type B) exempted from national insurance contributions. • *Social cooperatives* have the status of preferred providers in local authority procurement (direct).

Support Scheme	Spain	Italy
Grants, subsidies and donations.	• Grants and subsidies for incorporating certain type of workers (unemployed people) into cooperatives and worker-owned companies. • Investment support for worker-owned companies: interest subsidies and investments in fixed assets. • Possibility to capitalise unemployment benefits in case the beneficiary decides to launch a cooperative.	• Grants for pre-start / start-up support. • Grants and business support for established enterprises.
Financial instruments for *social enterprises*.	• (Public) financial instruments are at an early stage of development in Spain. The level of innovation and sophistication of the instruments is relatively low and the scope generic.	• Compared with Spain, there exists a relatively well developed ecosystem for financial instruments (e.g.: loans, guarantee schemes, social impact bonds, etc).
Technical assistance (consulting, mentoring, incubation, training, capacity building, investment readiness support, physical infrastructure).	• Technical assistance (in particular for early stage) mainly for feasibility studies, audits, consultancy and training.This support is channelled through foundations or organisations working at the regional level.	• Pre start/start up support (e.g. business support, mentoring, consultancy, coaching, etc). Grants, infrastructure (e.g. incubators). • Business support for established enterprises (e.g.: business planning, management skills, marketing, training and coaching etc.). • Physical infrastructure (e.g.: shared working space). • Collaborations and access to markets.
Communications and awareness raising: dissemination, communication, information, PR activities and awards	Dissemination and promotion of social economy activities linked with job creation, by CEPES and other organisations.	• Due to the legal category of "*social enterprise*" the awareness of *social enterprises* and their activities is relatively high compared with Spain. • Communication/dissemination activities realised mainly by networks of *social cooperatives*.
Networks, mutual support, cooperation.	• The concepts of *social enterprise* and social entrepreneurship are quite unknown in Spain, in comparison with other European countries, and the type and density of existing network / support mechanisms reflect that. • There is basically one umbrella organization: CEPES (Spanish Business Confederation of Social Economy), organisation integrating 28 organizations with various economic activities in the field of social economy.	• Networks of *social cooperatives* are well established in Italy. • Close cooperation with public authorities represents one of the main best practices in support initiatives for *social enterprises*. • *Social cooperatives* often group together in consortia to be effective in the market place (agreements for the supply of services to public administrations => allows small organisations to access procurement opportunities). • The consortia may act as guarantors for bank loans or for contract delivery.
Markings, labels and certification systems.	• Spain does not have a formal identification scheme, markings or labels for *social enterprises*. • Lack of a developed practice of social public procurement.	• There are significant markings: labelling schemes or certification systems for *social enterprises* in Italy. • Systems for social reporting which are specifically targeted at *social enterprises ex lege* and *social cooperatives* (mandatory).

Source: Own elaboration adapted from Country Reports Spain, Italy, European Commission.

There are some pros and cons in the D.Lgs 155/2006 that the new law is trying to replace

*Figure 09: **Legal changes in Italy.***

Regulation	PROs – CONs and relations with the third sector reform Law
Social enterprises (D. Lgs. 155/2006)	It sets a restrictive list of filed in which enterprises can work in order to be eligible as "social enterprises". ↗ Fiscal advantages ↗ Economic-financial advantages ↙ Impossible to distribute profit to shareholders ↙ Impossible to rise capital from external investors Scares diffusion. It will be replaced by the D.lgs. n. 112/2017
Social cooperatives (Law 381/1991)	↗ It is the most diffused type of social company. This law will be maintained but modified by the reform.
Associations of social promotion (Law 383/2000)	↙ It will be cancelled by the reform of the law for the third sector
Organizations of volunteers (Law 266/1991)	↙ It will be cancelled by the reform of the law for the third sector

Source: Own elaboration.

AN ALTERNATIVE WAY: FINANCIAL INSTRUMENTS FOR SOCIAL ENTERPRISES

Finally, of course, financial instruments represent the other, alternative, way to support and enhance this sector. Most country reports highlight that social enterprises, like any other enterprise, need external finance to start up and scale their activities. However, given their specific traits, accessing finance from traditional sources can be particularly problematic for social enterprises. **Given that social investment markets are currently underdeveloped in most European countries, governments can play a key role in stimulating the development of social investment markets, by designing dedicated financial instruments.** There are also interesting examples of publicly funded dedicated financial instruments (i.e.: repayable funds; not grants) in Belgium, Denmark, France, Ireland, Poland and the UK.

SUPPORT SCHEMES

1. **In Spain** *cooperatives* have access to several tax reductions, and worker-owned companies have access to investment support.
2. Public financial instruments are still in an early stage of development, with low innovation and sophistication levels.
3. Spain does not have a formal identification scheme.
4. **In Italy** there are no special labels or brands, but there is strong promotion of social start-ups.
5. Financial instruments are more developed and there is better cooperation with public authorities.
6. Finally, compared with Spain, the Italian "*social enterprise*" category creates a high level of awareness.

c Overview of key actors

To identify the key players, we differentiate between "*financial suppliers*" and "*other key players*". The goal is to draw a list of 5-10 (estimated) relevant players in each category:

- **Financial suppliers.** We clarify who are the principal players involved in financing the social economy, distinguishing between the following categories of financial entities or financial intermediaries: public intermediaries, commercial banks, ethical banks, others (crowdfunding platforms, venture capital, etc.)
- **Other key players:** non-financial key players / agents with influence or impact on the social sector should be listed –as for example, religious institutions, networks, lobbies, business clusters, associations, etc.–.

COMPARING KEY ACTORS IN SPAIN AND ITALY

In Spain, the decentralization of the state administration at the policy level, involves different actors which adapt their goals and rules to local problems and interests. Although there are some national organizations, like CEPES, many of the key actors promoted by the government are rooted in an Autonomous Community (region). Other key actors with a private bias are the foundations created by the savings banks. But they have seen their influence shrink considerably during the financial crisis.

In Italy, public policy is centralized and many of the key actors have a national scope. *Social cooperatives* have an important role because of their powerful networks focused at the local level.

The following chart compares some of the key actors and their characteristics in the social sector ecosystem of Spain and Italy (the list is not exhaustive):

Figure 10: ***Key actors of the social economy in Spain and Italy.***

Category	Spain	Italy
Governmental departments or institutions designing or implementing policy, support instruments and measures for social enterprises and infrastructures	Central government: specific Directorate General (DG) devoted to social economy within the Ministry of Labour and social economy. Andalusia: specific Directorate General (DG) devoted to social economy and freelance within the Regional Ministry of Economy.	Central Government: Ministry for Employment and Social Policies Regional and Local Authorities
Institutions, civil society initiatives or other social enterprises promoting social entrepreneurship education and training	FAIDEI (Federation of associations for professional integration of communities in risk of exclusion)	Gruppo Cooperativo CGM (network of > 1.000 social cooperatives)
Providers of social enterprise start up and development support services and facilities (such as incubators)	• PAEM –Programme to support women entrepreneurship) • La Caixa	CFI/Cooperazione Finanza Impresa

Category	Spain	Italy
Organisations that have the capacity act as an observatory and to monitor the development and to the assess needs and opportunities of social entrepreneurs/ social enterprises	CEPES (Spanish Business Confederation of Social Economy) Spanish Observatory of Social Economy National Institute of Statistics (INE)	• National Institute for Statistics (ISTAT) • Italian Chambers of Commerce (Infocamere), • National Network of Research Institutes on Social Enterprises (Iris Network). • Association for the promotion of the Culture of Cooperation and Non-profit (AICCON) • Italian Union of Chambers of Commerce (Unioncamere) • Gruppo Cooperativo CGM • UBI Banca Observatory (Osservatorio UBI Banca su "Finanza e Terzo Settore") • IRES Piemonte Piedmont's economic research institute (For Piedmont Region)
Facilitators of learning and exchange platforms for social enterprises	• Universities (University of Valencia, University of Zaragoza and University of Barcelona). • International projects: PERSE, EMES network, GEM. • Business schools (IESE, IE Business School, ESADE…)	• Association 'Impresasociale.net' (Isnet) • 'Idee in rete' consortium
Social enterprise (support) networks, associations	• FEACEM Business Federation of Associations of Sheltered Employment Centres) • REAS (Network of Alternative and Solidary Economy). • FAIDEI (Federation of associations for professional integration of communities in risk of exclusion) • Red de Emprendedores Sociales (Network of social entrepreneurs). • Asociación Española de Emprendedores Sociales (Spanish association of social entrepreneurs) • Valencia: Confederació de Cooperatives de la Comunitat Valenciana • Valencia: FEVES-FESAL, P.V.association of labor societies • Valencia: Agrupación Empresarial Valenciana de Centros Especiales de Empleo	• Gruppo Cooperativo CGM • Confcooperative • Wide range of social cooperatives confederations and other networks at local level (act as 'general contractor' for participation in public bids)
Other key players	ONCE (Organizacion Nacional de Ciegos Españoles –Spanish national organisation for blind people) enjoys a dual institutional nature (partly public). Entrusted with certain public functions by the State and partly but predominantly a membership-based corporation governed by private law.What makes ONCE Foundation so popular compared to other foundations is the way that it is financed. Its main income source is a lottery.	

Source: Own elaboration.

03

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03. MEASURING THE SOCIAL IMPACT (SI)

ⓐ **Social impact: measuring results**

ⓑ **The impact value chain**

ⓒ **Recommendations for the correct evaluation of SI**

INTRODUCTION

Measuring the impact is essential to know the social results of the activities of *social enterprises*. It is indispensable to provide this info to social investors, so they can gauge the impact of their investments. Along this chapter, the issue of measuring the social impact is set out.

Firstly, a general overview about social impact is presented. It is shown its challenges, difficulties to be implemented and the principal flow systems and methodologies.

After this setting out, we focused in "The Impact Value Chain" as one of the most used system to measuring of social impact. Every step and phase is discussed

And finally, we shows, in form of an accessible chart, some recommendations for an effective evaluation of social impact, including the more relevant principles which ought to be considered and the pitfalls to avoid, in order to achieve an efficacious impact measuring.

a) Social Impact: measuring results

Measuring the impact of *social enterprises* is a very complex task. Nonetheless, it is essential to know with a high degree of certainty and precision what are the social results obtained from the activities of the various agents involved in the *social economy*. Likewise, it is indispensable to provide this information in true form to social investors, so they can gauge the positive impact of their investments.

Some undertakings set out impact objectives which are exceedingly ambitious and complex to evaluate. Others, however, aim for goals which are simple or modest in scope and more evident to measure. For the latter, it is relatively easy to build a coherent performance and impact measurement system. As for the former, it is possible to think of a collectively created and implemented system; or, alternately, the measurement system might be subdivided into simpler components (implemented separately by the various actors and for the different lines of activity), making it easier to manage. The measurement instruments can vary from a simple *Excel* sheet to a more complex system based on customized software for each of the participating actors or lines of activity.

According to **Sophie Robin** in her paper "*Tools for Measuring Social Impact*" (PID_00188417), measuring impact is a way of learning. The difficult part is that this learning has to be transformed into practice –i.e.: a continuous improvement in the organization– which ought to lead to improvements in the quality of results and, therefore, also increasing its quantitative impact.

To be viable, the social impact must be linked to economic performance. More and more entrepreneurs have decided to use the market to help solve social problems. However, to be competitive in the market the entrepreneur needs to develop viable business strategies. But these are sometimes achieved at the cost of damaging the social impact. There is, thus, an identifiable trade-off between the two. Achieving a solid and manageable balance between economic growth and social impact is not an easy task. Both need to be measured simultaneously to ensure a coherent strategy. This is the key challenge for the social entrepreneur.

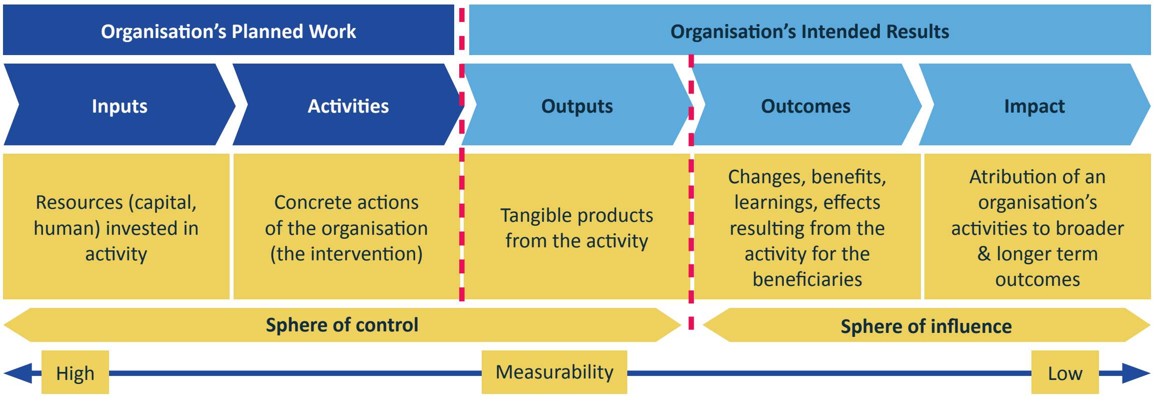
There are many available methods and different software programs to measure social impact. None is capable of responding with full confidence or 100% precision to the diverse situations faced by the vast array of social initiatives.

The measurement of social impact is based on a widely accepted flow system, variously known as the Impact Value Chain, Change Theory or Logical Model. There are many methodologies and tools to measure social impact. The most widely used are: SROI, IRIS, PULSE, the Social Enterprise Balanced Scorecard (SEBS), Social Accounting and Audit (SAA), etc.

The measurement of impact is based on a widely recognised flow, variously known as the Impact Value Chain, Theory of Change or Logic Model.

ⓑ The impact value chain

Figure 11: ***The impact value chain.***



The purpose of measurement of social impact is normally not related to financial instrument. The reasons for measuring social impact can be various:

- Legal requeriment (France "rivision coopérative", Italy "bilancio sociale")
- External requirement from stakeholders, investors, customers, providers, etc.
- Internal requirement (internal policy, transparency, etc.)

Source: Own elaboration adapted from European Commission, OECD.

Even though many of these models have similar elements –to include stakeholders in the process, to combine good internal management with measurable external impacts, to link social results with financial results, etc.– to a certain extent they can be considered "*competing*" models. Choosing between them will depend on the particular combination of objectives and resources available to the *social enterprise*.

To provide some guidance in this labyrinth of methodologies, databases and tools for measuring social impact, the European Venture Philanthropy Association (EVPA) has created a guide: "*A Practical Guide to Measuring and Managing Impact*" (June 2015). It is a roadmap that facilitates the work of *philanthropic investment entities and social investors* (EFI / IS in their Spanish acronyms).

Some of the recommended tools to help EFIs establish their own objectives have been mentioned above: the Theory of Change, the Logical Model and certain parts of methodologies such as SROI or the Integral Scorecard (also based on the Theory of Change).

The EVPA synthesizes the best practices in social impact measurement in five steps presented in sequential order.

Figure 12: ***The impact value chain.***

Source: EVPA.

These steps comprise the process that should be followed by any entity endeavoring to measure the impact of its activity. They also synthesize the process proposed by the majority of the current methods and practices.

They are also the steps used in the European Standard of Measurement of Impact agreed in June 2017 by the European Commission.

I.- A social impact measurement procedure

The following are the steps in the process of implementing the measurement of *social impact*:

- **Planning / setting objectives** so that *external* stakeholders can understand the social initiative and decide whether or not to support it. *Internally*, the planning enables to be managed and applied more effectively to what is most likely to deliver the desired outcomes.

- **Engaging stakeholders and analyzing their interests:** here the benefiting stakeholders are identified and the nature of the benefits that accrue to them recognized. Internal stakeholders -trustees, management, employees and volunteers, present and past-learn together about the proposed social intervention and share in the expectation of the collective value it can bring.
- **Setting relevant impact measures:** at this stage the *social enterprise* will plan its intervention, and how the activity will achieve the outcomes / impacts on its beneficiaries and stakeholders. This link from activity to impact is the *social enterprise's* Theory of Change. In establishing this link, and setting the measurement method most appropriate to evaluate its performance, the social enterprise has to achieve the agreement / consensus of its major stakeholders.
- **Measuring, validating and valuing:** assessing whether the targeted outcomes are actually achieved in practice, whether they are apparent to the stakeholders intended to benefit, and whether they are valuable to them.
- **Reporting, learning and improvement:** as the services are delivered and the measurements of their effectiveness emerge, these results are reported regularly and meaningfully to internal and external audiences. This enables each stakeholder, and most importantly those most directly concerned with the service delivered, to learn by revisiting, refocusing and improving the services.

New donors want to make sure that the funds they provide are well spent. That is to say that the organizations to which they donate not only do good, but they do it well.

The Guide focuses on two levels: a) how to manage and measure the impact of specific investments in social projects; and b) how to evaluate the contribution of *philanthropic investment entities and social investors* (EFI / IS in Spanish) in generating such impact.

The objective of impact measurement is to manage and control the process of generating social impact, in order optimize it in relation to its costs.

Impact management must be continuous: it is easier if it is integrated into the investment management process. It is important to identify what aspects may need to be changed in the investment management process in order to maximize the social impact. For this reason, impact management is the center of the impact measurement process. At each step in the process, it must be considered to what extent it relates to the daily work of financing and managing the social project.

The following are, by way of conclusions, our recommendations on the correct procedures and standards in measuring the social impact:

c) Recommendations for an effective evaluation of Social Impact

Figure 13: ***The effective evaluation of Social Impact.***

Principles for an effective impact measurement	Pitfalls in achieving effective measurement
• **Relevant:** related to, and arising from the outcomes it is measuring. • **Helpful:** in meeting the needs of stakeholders, both internal and external. • **Simple:** both in how the measurement is made, and in how it is presented. • **Natural:** arising from the normal flow from activity to outcome. • **Certain:** both in how it is derived, and in how it is presented. • **Understood and accepted:** by all relevant stakeholders. • **Transparent and well-explained:** so that the methods by which the measurement is made, and how that relates to the services and outcomes concerned, are clear. • **Founded in evidence:** so that it can be tested, validated and form the grounds for continuous improvement.	• **Measurement driven bahaviours:** recognize that measurement does, and should, drive behaviours of the stakeholders. *"You get what you measure"*. • **Perverse incentives:** the measure should not induce the social company to select a target (*"cherry picking"*), so as to secure that indicators are met rather than to deliver social impact as intended. • **Manipulation or *"gaming"*:** with any measurement there are those that will try to play the system to enable targets to be shown to be achieved. • **Outputs being treated as outcomes or impacts:** whilst a service delivery organisation may be focused on delivering outputs, these are not in themselves the objective, but a means to achieving them. • **Excessive bureaucracy:** measurement should help, not take up scarce resources, or slow down decision-making for *social enterprises*.

Sources: Own elaboration adapted from GECES Sub-group on Impact Measurement.

CONCLUSIONS

Measuring the Social Impact

Measurement drives behaviour: *"you get what you measure"*

1. <u>All methods</u> (Impact Value Chain, Theory of Change, Logical Model) <u>follow five steps:</u>
   a) **planning / setting objectives**
   b) **engaging&analysing stakeholders**
   c) **setting relevant measures**
   d) **measuring, validating and valuing**
   e) **reporting, learning and improvement**
2. <u>All models share elements:</u>
   1. **Include stakeholders in** the process
   2. **Combine sound internal management with measurable external impacts**
   3. **Link social results with financial ones**
3. <u>The principles for an effective measurement of SI</u>: it must be **relevant&helpful, simple, natural, certain, understood & accepted, transparent&well explained and founded on evidence.**
4. <u>Pitfalls to be avoided in measuring</u>:
   1. **Cherry picking targets** which are not real indicators
   2. **Manipulating measurements**
   3. **Treating outputs** (of company's economic activity) **as social impact**
   4. Devoting **excessive bureaucracy** to implement it.

04

ASSESSMENT OF STATE
OF THE ART OF FINANCIAL INSTRUMENTS
ADDRESSED TO ENTERPRISES/INITIATIVES
PRODUCING RELEVANT **SOCIAL IMPACT**

2018

Piedmont
Lombardy
Andalusia
Valencia

04. ANALYSIS OF THE NEEDS OF SOCIAL ENTERPRISES

INTRODUCTION

In this chapter, analysing the needs for financial instruments in the social sector, we start with the main traits which social enterprises have to tackle and their implications for access to finance, following with the weaknesses of social enterprises, which are external (national rules, reliance on public sector, social perception) and internal (lack of commercial orientation and managerial skills, absence of a social benefits model). We also describe the decision-making system of financial entities vis-a-vis social enterprises and why the reject financing them. Finally, we summarize the relevant surveys/reports on the types of investors and investments on offer, and how they perform for the social sector, especially with regards to the different stages of development of social enterprises.

a) The main traits of social enterprises and implications for their access to finance

The following graphic shows the main traits of these SEs, in terms of size, structure, assets, profitability, human resources, etc.

These traits have significant implications for their access to finance. This information is very helpful for designing and selecting the financial instruments that better fit this type of enterprises.

Figure 14: ***Traits of social enterprises: financial implications.***

Characteristics of *social enterprises* and their enviroment

- Lack of sustainable and/or scalable business models.
- High reliance on the public sector as a source of income (=> no long term planning possible, exposed to budget cuts and regulatory/policy changes).
- Intrinsic low solvency (equity) ratios.
- Small/subcritical size of organisations.
- Lack of collaterals (they do not exist or are prohibited from guaranteeing loans).
- Limitations on distribution of profits to investors.
- Lack of sufficient entrepreneurial spirit and commercial orientation.
- Lack of managerial and professional skills and competencies: difficulty to attract highly qualified workers with sufficient managerial experience (limited capacity to offer competitive salaries).
- Access to markets: inadequate use of social clauses, current public procurement practices (large contract volumes, disproportionate pre-qualification requirements, etc.) and payment delays make it difficult for *social enterprises* to effectively compete in public procurement markets.

Implications

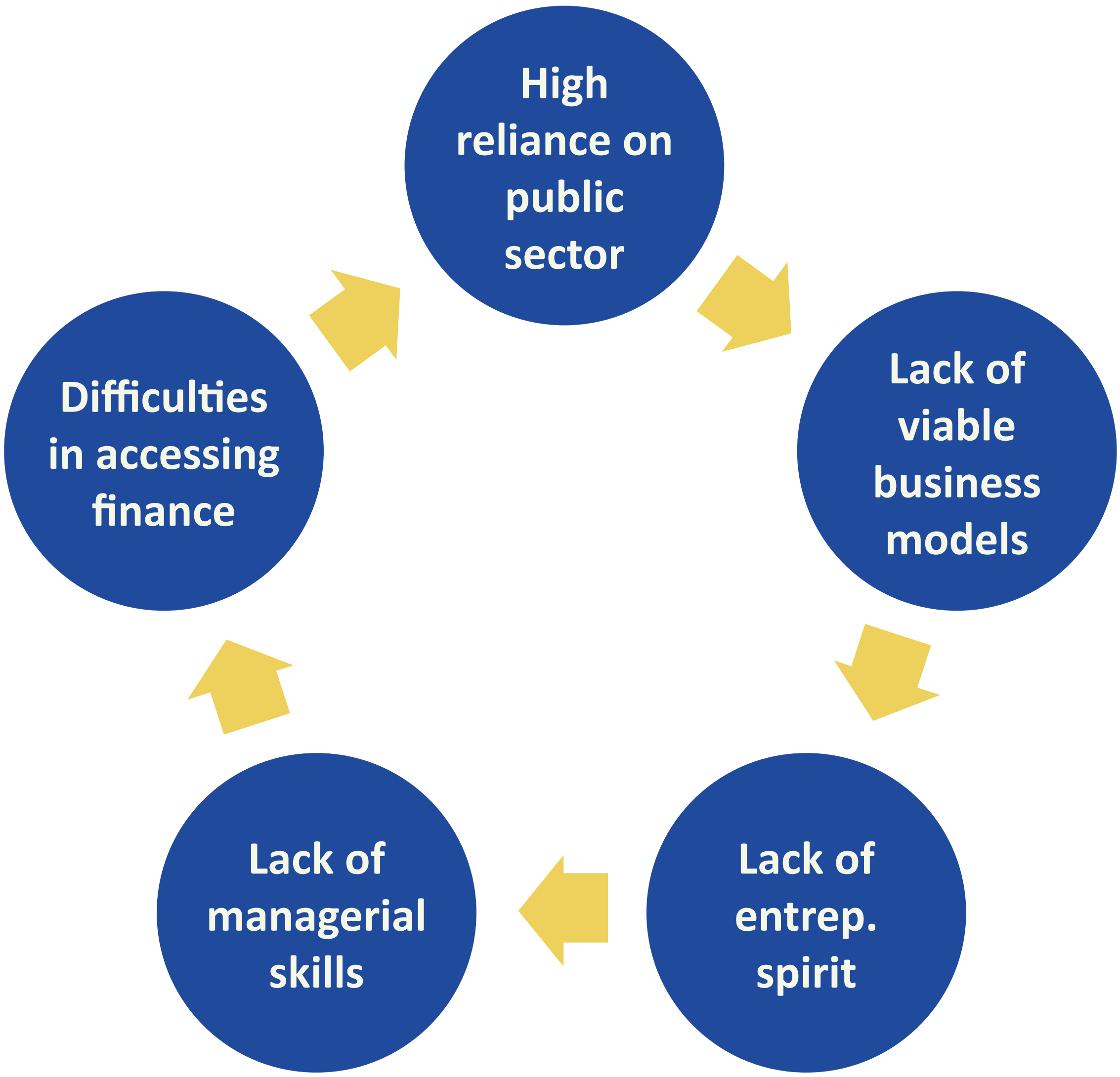
- Access to finance is the key constraint for the development of *social enterprises*.
- No appropriate response from mainstream banking solutions:
  - Risk: perception of high risk but no collateral.
  - Return: high transaction costs for expected below-market returns.
  - Impact: positive externalities not recognized / taken into account.
- Difficulties in accessing external finance along the complete company lifecycle (in particular early stage) and regarding all types of financial products (debt and equity).
- Intermediaries and advisors are hard tos finance due to high operating costs.

Source: Own elaboration.

ⓑ Weaknesses of social enterprises

In this analysis it is observed a significant interdependence between the various weaknesses, as some help explain the others. The lack of viable business models is a consequence of the lack of entrepreneurial spirit; the first three weaknesses are the cause of the fourth. It is a vicious circle very difficult to overcome.

Figure 15: ***How weaknesses of social enterprises are mutually reinforcing.***



Source: Own elaboration.

I.- Internal weaknesses

These are the fundamental causes of *internal* weakness:

- **Lack of viable business models**

  In many countries, stakeholders have mentioned the absence of viable business models as a major constraint to the sustainability and growth prospects of *social enterprises.* This issue is linked to:

  - High reliance on the public sector as a source of income.
  - Lack of business skills and competence.

  Social enterprises cannot hire the best possible employees due to the reduced salaries they can offer.

- **Lack of sufficient entrepreneurial spirit and commercial orientation**

  Commercial orientation is required to translate ideas into successful business models. This is interlinked with the external support needed. One key area impacting on this is the lack of managerial skills and know-how on key business-related issues. Success depends on the attitude of the entrepreneur, who should combine engagement with economic realism, knowing how to access subsidies, funds as well as networks, legislation and government agencies for specialist knowledge and support.

- **Lack of solid organizational structure**

  Social enterprises often lack long-term, strategically oriented organizational structures –the roles of the board of directors and the executive director often mix and overlap, failing to provide long-term vision. The reason for this is that they are usually focused on the social issue and all the organization is built and oriented around it. Finally, they have insufficient resources and capacity to develop and scale their operations, which affects the ability of *social enterprises* to become commercially oriented. This is related to business support as well as financial resources. In some countries, interviews with *social enterprises* indicate that nearly a quarter of their annual income comes from the founders' pockets. Further, there is a low desire to seek financing, due to low business financing skills and lack of collateral. This prevents sustainability and capacity development.

- **Lack of managerial and professional skills and competence**

  In many European countries, attracting highly qualified workers with sufficient managerial experience has been identified as a barrier. This obstacle reflects the higher wage costs of highly qualified workers; whereas *social enterprises* in general have limited resources to offer competitive salaries, compared to other sectors of the economy.

II.- External weaknesses

A number of problems have been detected in the external environment of social enterprises:

- **National rules and regulations**

  A number of member states of the EU have difficulties as a result of national rules or regulations. For example, not-for-profit social enterprises in some countries have limited access to bank finance due to national bank rules, which places them in the riskiest category as borrowers. This means that banks are reluctant to meet their financing needs. In other countries, organisations are prohibited from using property to guarantee loans. Generally, bank credit shortage is one of the barriers that entrepreneurs face in establishing, developing or expanding social enterprises. According to some experts (Marta García Abadía, from Social Finance), the lack of adaptation of national rules to the social enterprise scene is the biggest problem.

For example, in many countries there are no advisory contracts whereby you can pay with a success fee.

- **Corporate law**

  Many stakeholders have noted that the limited degree to which social enterprises can distribute profits to investors inhibits access to (equity) finance. As a rule, social enterprises are characterized by limitations on the profits they can distribute. Additionally, some limitations on the size and scope of social enterprises place further restrictions on profits. As an example, in some countries only companies with social purpose structures are able to distribute a dividend, thus being more attractive to investors (and having greater access to finance) than non-profit legal forms that are denied profit distribution.

- **Limited financial instruments for social enterprises**

  Several country reports highlight the limited range of financial instruments available to investors.

- **How society perceives social enterprises**

  Another limiting factor is the lack of understanding of social enterprises. This perception varies country by country. In some, banks and investors do not recognize the special traits of social enterprises when making lending or investment decisions. In other countries, social enterprises are seen as financed primarily by the state and, therefore, as not self-sustaining or able to make a profit. In other countries, still, social enterprises have weak credibility (particularly in the start-up phase) because of their dependency on public support and their prioritizing of social impact over profit.

- **Is not easy to measure the social impact**

  Finally, combining social impact and profits is a difficult balancing act for social enterprises, especially when the former is not as readily measurable as the latter.

CONCLUSIONS

The Weaknesses of Social Enterprises

The combination of *internal* and *external* causes of weakness creates a vicious circle very difficult to overcome.

Access to finance is a constant problem for the development of *social enterprises*.

There are considerable difficulties in accessing *external* finance during the complete lifecycle of the company, and with regard to all types of financial products.

External problems detected:

- The legal regulations of many states make it difficult to develop financial instruments.
- Commercial regulations limiting the freedom of action of *social enterprises*.
- How society perceives *social enterprises.*
- Difficulty in measuring social impact.

c) Financial Needs of *social enterprises*

I.- Analysis of the needs of *social enterprises*

Having presented the particular characteristics of social enterprises and how they affect their access to financing, as well as the main weaknesses (internal and external) they face and the strong interdependence between them; it is necessary to evaluate the different needs that companies in the social sector require to address the weaknesses and challenges they face.

The approach that has been used to determine the necessary measures starts from the fact, already commented, that these factors are intimately imbricated in such a way that they form a sort of 'vicious circle'. So it would not be ad-hoc actions for each weakness that you want to tackle, but each and all in turn would act on the set of weaknesses, some with greater weight in some aspects compared to others, but without being able to isolate every need with a concrete weakness.

Together with the above, it has been considered that the external weaknesses identified would, in fact, be the boundary conditions or, if preferred, the framework in which the social enterprises operate and, consequently, they would be outside the perimeter of action of the IFISE project. These conditions depend on laws, regulations, economic structure of the territories, historical considerations, etc., which clearly are not part of the field where the IFISE project is developed.

That said, the following table shows the main needs of social enterprises versus the internal weaknesses detected. The measures have been divided between those that have the greatest impact on the objectives of the IFISE project and those that would have a lesser relevance, although not with less capacity to deal with the weaknesses of social enterprises.

Figure 16.

WEAKNESSES	NEEDS OF SOCIAL ENTERPRISES	MEASURES TO SOCIAL ENTERPRISES	
• Lack of viable business models • Lack of entrepreneurial spirit • Lack of managerial skills • Difficulties in accessing finance • High reliance on public sector	• Facilitate/enable access to finance • Compensation lack of profitability • Capacity building • Lobbying/Awareness/ Consciousness-raising of society about social economy • Consideration of positive (direct + indirect) externalities of social economy	• Financial instruments for Social Enterprises • Grants, subsidies and donations • Technical assistance • Social clauses in procurements • Communications and awareness raising; dissemination, communication, information, PR activities and awards • Netowrks, mutual support, cooperation • Markings, labels and certification systems.	↑ Relevance for IFISE

Source: Own elaboration.

II.- Difficulties for social enterprises in accessing (external) finance

As a result of all these weaknesses, access to finance was identified across Europe as a significant barrier to the development of social enterprises. For example, in one country, over a third of social enterprises do not have a single line of credit; in another country this figure is 40%. Financing at the start-up phase was highlighted as particularly problematic in some countries, whereas financing for growth and scaling up activities was identified as a larger gap. In other countries, financing difficulties was prevalent across the whole lifecycle of the social enterprise.

III.- The problem with banks

Lack of understanding of this type of enterprises, concern over issues of governance, low potential returns compared to other investment activities and poor risk profiles are all commonly prevalent in the bank lending markets for social enterprises.

Banks usually perform a common and undifferentiated process in the assignment of risks to projects and companies, based on a balance between payment capacity, guarantees and profitability. The absence of long-term business plans or models, lack of commercial orientation and poor management skills, understandably make it difficult to finance this kind of projects through the banks.

IV.- Decision tree for financing of social enterprises

Next we describe the decision tree for access to financial resources in the case of social enterprises. This decision tree applies generally to all conceivable financial actors. The questions posed define the kind of instruments a project can ask for, from philanthropy funds to equity and loans. To reach this status an enterprise has to have a commercial business model with sufficient working capital to be eligible for financing. Moreover, if the project needs long term resources, it has to be in a position to offer assets; or a guaranteed capacity for repayment and/or profitability if it is to have a satisfactory valuation to attract equity investors.

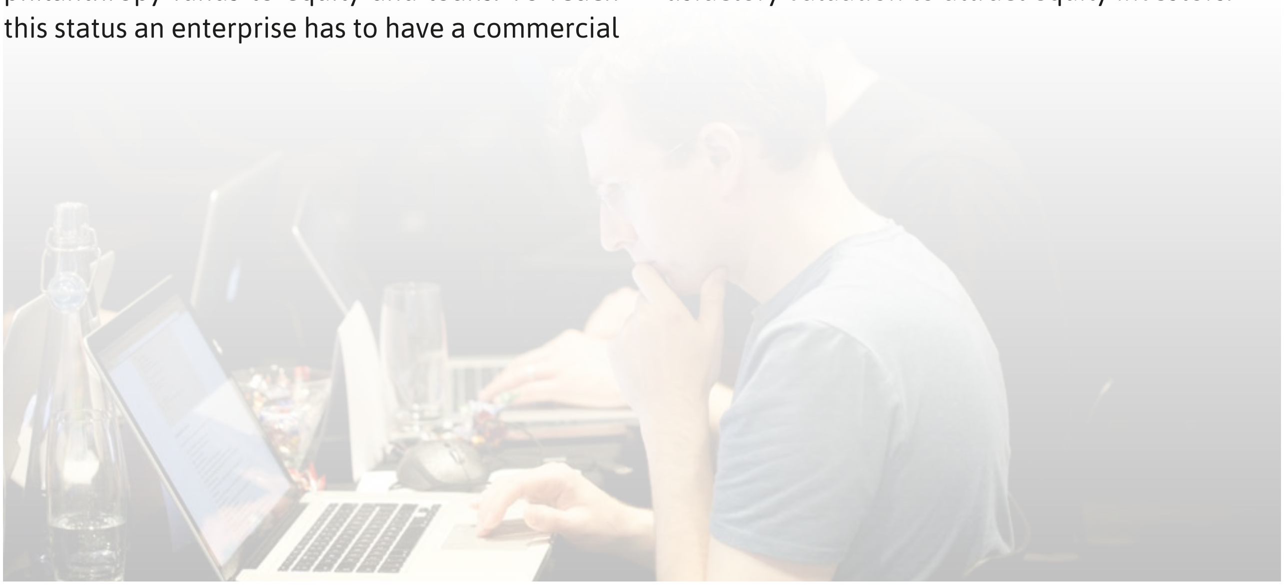
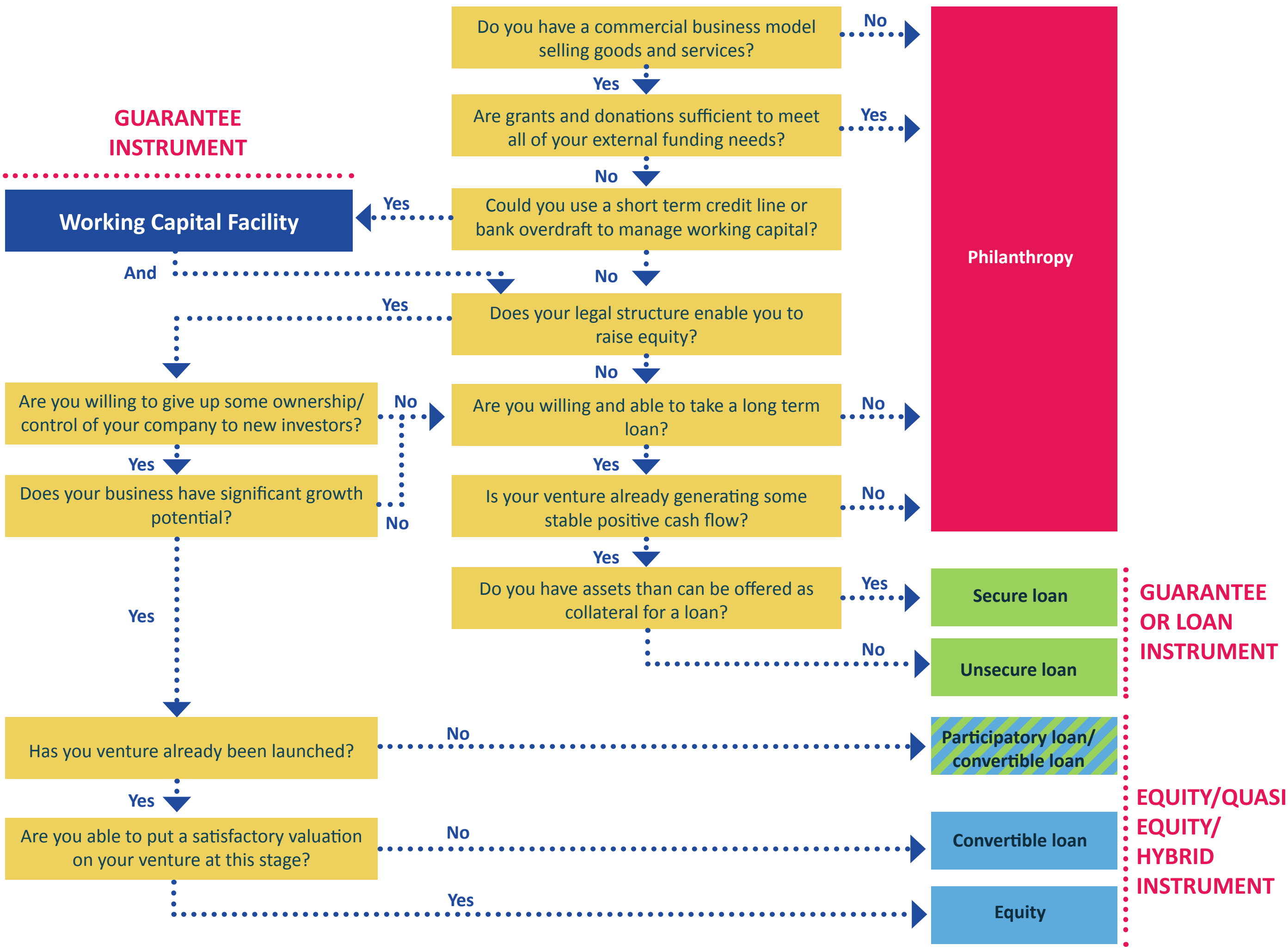


Figure 17: ***Decision tree for access to finance by social enterprises.***



Source: Own elaboration adapted from Mark Cheng, the Europe Director of Ashoka.

V.- Types of investors and investments needed

Overview of private investors and typical financing instruments

The next chart describes the most common types of investment used by investors for this kind of enterprises. The financial instruments (FI) are grouped in three categories:

- Equity
- Quasi-equity / hybrid: participatory loans, mezzanine, etc
- Debt

The first two categories are the most prevalent because of the weaknesses and problems described in previous chapters.

Figure 18: ***Types of investors and financial instruments for social enterprises.***

<table>
<tr><th></th><th>Equity</th><th>Quasi Equity / Hybrid</th><th>Debt</th></tr>
<tr><td>Private Investors</td><td colspan="3">• Friends & Family
• Business Angels
• High Net Worth Individual (HNWI)</td></tr>
<tr><td>Investments Funds</td><td colspan="2">• Seed Capital Funds
• Venture Capital (VC) Funds
• Social VC Funds
• Corporate VC Funds
• Private Equity (PE) Funds</td><td>-</td></tr>
<tr><td>Other Institutional Investors</td><td colspan="2">• Banks (own investments)
• Family offices</td><td>• Banks
• Social Banks
• Loan Funds
• Guarantee Funds
• Microfinance Funds</td></tr>
<tr><td>Crowdfinancing Platforms</td><td colspan="2">• Crowdinvestors</td><td>• Crowdlenders</td></tr>
</table>

Source: Own elaboration.

The following are the main types of investors concerned with the social sector:

- **Private investors:** this group is divided into three according to: a) their *professionalism*; b) their *proximity* to the project; and c) their investment *intensity*.
- **Investment funds:** all of them regulated by national or European capital laws.
- **Other institutional investors:** banks and family offices (the latter could also be grouped with private investors).
- **Crowdfinancing platforms:** it represents one of the Internet fuelled revolutions in financing in recent years. Its development varies depending on national laws.

Matching financial instruments with types of social enterprise

Next we provide a map that shows neatly (horizontal axis) the difference between projects whose *primary driver* is to create *social impact* and those whose driver is the *financial return*. We also differentiate (vertical axis) between projects in an *early* or a *later* stage of development.

The variety of accessible FI is higher for projects for which financial return is important. This is to be expected as FI such as loans (subordinated or not) take into account profitability and capacity to reimburse the investment.

Figure 19: ***Matching financial instruments and types of social enterprise.***

			Type of social company			
			Impact only	Impact first (financial return accepted)	Impact first (financial return on same level)	Finance first (with social activity)
Type of business model	Lineal / static business models					
	Social ventures / Scaling business model					
Typical financing instrument	Early stage	Grants	√	√	√	√
		SIB				
		Equity / social venture			√	√
		Hybrid / quasi equity			√	√
		Subordinated loan				√
		Secured loan				
		Crowd investing	√	√	√	√
	Later stage	Grants	√	√		
		SIB	√	√	√	√
		Equity / social venture				√
		Hybrid / quasi equity		√	√	√
		Subordinated loan		√	√	√
		Secured loan			√	√
		Crowd investing				

Source: Own elaboration adapted from Impact in Motion.

Overview of most common sources of private finance throughout the lifecycle of a SE

The next chart describes how the most likely type of investor varies throughout the lifecycle of a social enterprise: from the idea, seed and start-up phases, in the early stage, through growth, maturity and consolidation in the later stage. The financial needs grow from near cero to more than 1,5M € in this period. The typical investors that can inject funds in each of these phases are the same as those that invest in projects with no social impact goals.

Figure 20: ***Types of investor and capital needs throughout the SE lifecycle.***

		Early Stage			Later Stage		
		Idea	**Seed**	**Start-up**	**Growth**	**Maturity**	**Consolidation**
Traits		Proof of concept, business plan development	Company founded, product development, pilot production / delivery	Execution of market launch, first commercial revenues	Early scaling of business, significant growth (reaching break even)	Breakout scaling, increased standardization (positive cash-flow)	Breakout scaling, increased standardization (positive cash-flow)
Typical capital need (€)		0 - 100k	100k - 500k	100k - 1,5m	>100k	>500k	>500k
Investment Ticket	**>1,5 m**			• VC/CVC Funds	• VC/CVC Funds	• VC/CVC Funds • PE Funds • Banks • Social Banks	• PE Funds • Banks • Social Banks
Investment Ticket	**500k - 1,5m**			• VC/CVC Funds • Social VC Funds • Seed Capital Funds • Crowdinvesting	• VC/CVC Funds • Social VC Funds • Seed Capital Funds • Crowdinvesting	• VC/CVC Funds • Social VC Funds • Banks • Social Banks	• Banks • Social Banks
Investment Ticket	**100k - 500k**		• Seed Capital Funds • Business Angels • Crowdinvesting	• Business Angels • Crowdinvesting	• Business Angels • Crowdinvesting		
Investment Ticket	**0 - 100k**	• Friends & Family	• Business Angels • Crowdinvesting • Microfinance Funds • Friends & Family	• Business Angels • Crowdinvesting • Microfinance Funds • Friends & Family			

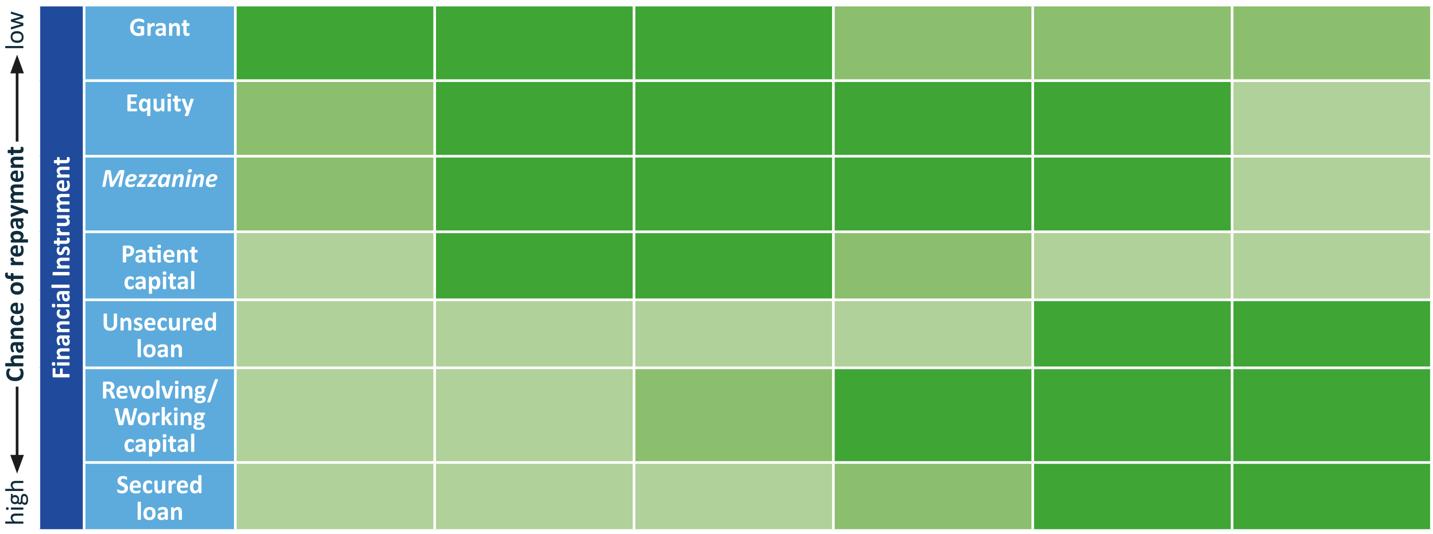
Source: Own elaboration adapted from Impact in Motion.

Matching financial instruments with financial needs throughout the lifecycle of social ventures

The next chart shows what happens during the life-cycle of the SE and the type of FI social projects are eligible for in each phase.

Figure 21: ***Financial instruments and financial needs through the SE lifecycle.***

	Early Stage			Later Stage		
	Idea	**Seed**	**Start-up**	**Growth**	**Maturity**	**Consolidation**
Traits	Proof of concept, business plan development	Company founded, product development, pilot production / delivery	Execution of market launch, first commercial revenues	Early scaling of business, significant growth (reaching break even)	Breakout scaling, increased standardization (positive cash-flow)	Breakout scaling, increased standardization (positive cash-flow)
Typical capital need (€)	0 - 100k	100k - 500k	100k - 1,5m	>100k	>500k	>500k



Source: Own elaboration.

As the project grows, upgrading to higher phases/ stages, the access to FI in need of reimbursement is higher. The reason is clear: risks diminish with each passing phase/stage, and lenders can evaluate with increasing certainty the capacity of the SE to reimburse the investment.

Once having analyzed the main typologies of investors and the financial instruments commonly utilized by them, and once having studied how the different types of investors and financial instruments have evolved throughout the life-cycle of the social enterprises, is important to study the adequacy of each instrument for each type of investor, measuring how they match each other. That way we get to know the investor's opinion about the instruments, and whether they match their needs throughout the life of the social enterprises

Cristina López-Cózara y Tiziana Priedeb, in their report "*Identificación de las Principales Fuentes de Financiación Empleadas por la Empresa Social en la Actualidad*", use the Delphi Method to measure how social entrepreneurs evaluate the various financial mechanisms available.

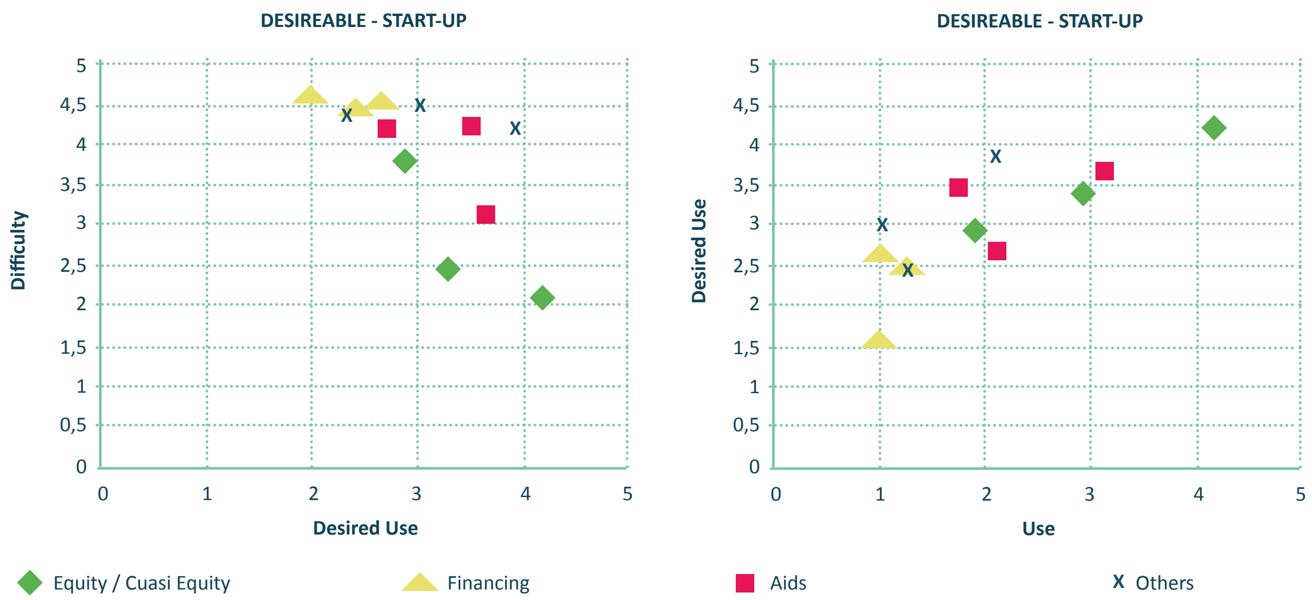
Their analysis considers three topics:

- Main financial instruments in the phase of project creation.

- Main financial instruments in the phase of growth & development.
- Most appropriate financial instruments, according to social entrepreneurs.

In the following sections, we analyze each of these topics and draw the relevant conclusions.

Figure 22: ***Financial instruments in the start-up phase: relevance and difficulty.***



Source: Own elaboration, data based on"Identificación de las Principales Fuentes de Financiación Empleadas por la Empresa Social en la Actualidad".

From this chart, it is clear that, in this phase, the main sources of financial resources are:

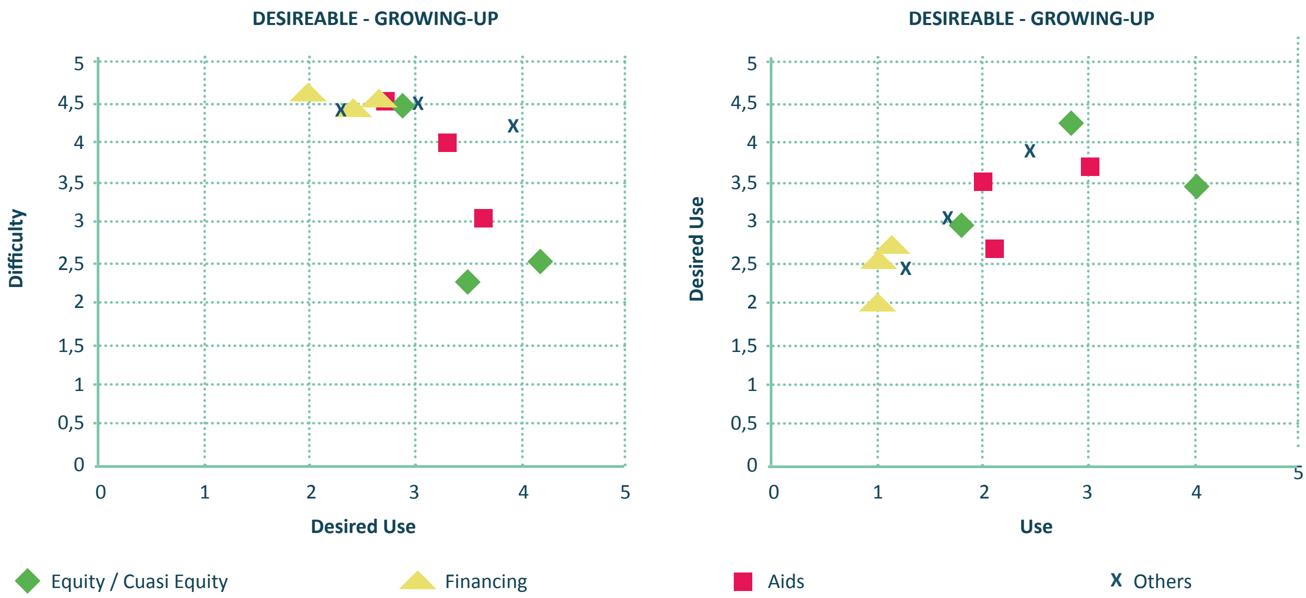
- Equity from founders
- Prizes and the Family, Friends & Fools (3Fs)

The access difficulty of these financial instruments has been evaluated as well, with the following results.

The most difficult instruments are:

- Public and private grants
- Loans from banks and RGS
- Venture capital
- Crowdfunding

Figure 23: ***Financial instruments in growth & development phase: usage and difficulty.***



Source: Own elaboration, data based on"Identificación de las Principales Fuentes de Financiación Empleadas por la Empresa Social en la Actualidad".

The above-mentioned results describes clearly that usability is inversely proportional to difficulty.

The chart clearly shows that in this phase the main sources of financing are:

- Equity from founders: capital increase and self-financing
- Prizes and the 3Fs
- Crowdfounding

The access difficulty for these financial instruments has been evaluated: all instruments have been appraised as extremely difficult to obtain.

THE MOST APPROPRIATE FINANCIAL INSTRUMENTS

Finally, in the following chart we can see the results of the survey on the most appropriate financial instruments, according to social entrepreneurs:

Figure 24: ***Results of the survey.***

Funding Source	Average	Median	Mode	k	Consensus
Own Funds: Entrepreneur Savings	4,22	4	5	1	Acceptable
Own Funds: 3Fs	3,44	4	5	2	No
Own Funds: Self-funding	4,78	5	5	0	Total

Funding Source	Average	Median	Mode	k	Consensus
Public Support (Grants)	3,44	3	2	3	No
Assistance from Private Enterprises	2,67	3	3	1	Acceptable
Prizes / Open calls	3,67	4	3	1	Acceptable
Loans from Public Financial Entities	2,67	3	3	1	Acceptable
Loans from Private Financial Entities	2,00	2	1	2	No
Participating / Mezzanine Loans	2,89	3	4	2	No
MGS	2,44	2	4	3	No
Venture Capital	2,33	2	2	1	Acceptable
Business Angel	3,00	3	3	1	Acceptable
Crowdfunding	3,89	4	4	1	Acceptable

Source: "Identificación de las Principales Fuentes de Financiación Empleadas por la Empresa Social en la Actualidad".

The most recommended financing methods are, by order of preference:

1. Self-financing.
2. 3Fs, crowdfunding and prizes.
3. Public and private grants, participatory loans and business angels.
4. Venture capital and grants.

CONCLUSIONS

Types of Investors and Investments for the Social Sector

Most common sources of finance: equity, prizes and 3Fs.

Most difficult sources: grants, loans, venture capital and crowdfunding.

Usability is inversely proportional to difficulty of implementation.

The most recommended financing methods are:

- Self financing
- 3Fs, crowdfunding and prizes
- Grants and *mezzanine*
- Venture capital

Regardless of the company lifecycle (*seed / start up and scaling / expansion*) "*alternative*" and "*equity / quasi-equity*" instruments are evaluated as the most desired instruments. These instruments need to be developed further.

05

ASSESSMENT OF STATE
OF THE ART OF FINANCIAL INSTRUMENTS
ADDRESSED TO ENTERPRISES/INITIATIVES
PRODUCING RELEVANT **SOCIAL IMPACT**

2018

Piedmont
Lombardy
Andalusia
Valencia

05. SUPPLY SIDE OF FINANCIAL INSTRUMENTS / STATE OF THE ART OF FINANCIAL INSTRUMENTS:

INTRODUCTION

This chapter, after introducing the scope of the survey of the IFISE project, starts with broad historical introduction into the world of *Social Impact Investments* (SIIs), which in recent times has acquired a new international relevance with the growth of microfinance. This allows us to introduce the concept of Social Impact Bond (ISB), one of the fastest growing financial instruments of recent years.

Next we describe the ecosystem of social investment players, both public and private, with a focus on the situation in Spain and Italy. The state of the art of the available financial instruments is explained, detailing six broad categories: loans, guarantees, equity/quasy-equity, SIBs, microcredits and crowdfunding). Then, we analyse those instruments through four charts: a) an analysis of FIs from the point of view of geographical scope, country, type of instruments and intermediaries, exploring in each case whether they are funded with ESI or not; b) market penetration of FIs by country; c) to what sectors (growing or not growing) the social investment is going; and d) overall asset allocation by instrument and stage of development of the *social enterprise*. Finally, we offer our recommendation on criteria for selecting the most adequate financial instrument.

We wrap up the chapter with an evaluation of the performance of SIBs, after analysing 138 138 instruments of this type.

a) Introduction: the scope of the survey of the IFISE project

In order to study the current situation of financing focused on the social sphere, as well as the different types of financial instruments, more than 50 cases have been analysed within the EU, and some more -mainly regarding Social Impact Bonds (SIB's)- in non-EU countries.

Firstly, it is necessary to introduce the concept of Social Impact Bond (SIB) since, hereafter it will be widely used along the document. A Social Impact Bond is a contract between public authorities, private investors and private social service providers, whereby the private investors pre-finance the social undertaking and only will be rewarded in case of the achievement of the expected social impact by public money.

Different aspects of each instrument have been analysed, such as the public or private nature of the issuer, the types of intermediaries, the public or private origin of the funds, etc.

As part of Phase 1 of the project, MARKET KNOWLEDGE, one of the key activities was to draw a map of the State of the Art of Financial Instruments. The methodology used to perform this task is described in this section.

As a first step the project partners had to compile a long list of potentially interesting financial instruments related to the Social Economy at the European level. The objective of this first phase

Figure 25: ***Information analyzed in this section.***

54 case studies of financial instruments	• In total, 54 social financial instruments from different (European) countries. – 40 instruments without ESI Funds. – 14 with ESI funds (ERDF or ESF). • Exploitation of qualitative and quantitative information based on a grid ("*short grid*" and "*full grid*").
138 Social Impact Bonds	• Analysis of 138 different Social Impact Bonds (local, regional, national, transnational) implemented in 35 different countries (worldwide), of which 40 are from UK and 20 from USA. • Exploitation of qualitative and quantitative information based on database (provided by Instigio).
Other information	• Relevant study reports. • Desktop research.

Source: Own elaboration, based on Consortium and Istigio data.

was to provide as wide a vision as possible of the different funding mechanisms available to *social enterprises* in Europe.

At first, a detailed list of characteristics to survey was produced. However, after a first screening of each instrument, the list of traits was reduced in order to analyze in depth only those which added value in the process of drawing conclusions on the design quality of the instrument and its effectiveness in financing *social enterprises* and projects. At the end of this screening process, an additional objective was to define a set of good practices that would be helpful in the future in creating new financial instruments focused on the Social Economy.

In order to evaluate the different financial instruments and make them comparable on the basis of all these selected traits, we have designed a standardized grid whose template can be found in Annex A. In that grid, a set of relevant questions are asked, related to key dimensions/variables which summarily characterize each of the reviewed financial instruments, so as to render them easily analyzed and classified.

Finally, and following the grid, each partner was assigned 12 to 15 selected instruments, for him/her to analyze in depth through desk research and interviews. This aim here was to study those instruments in depth, in order to figure out the best available practices in financing the Social Economy.

As a result of this mapping, the data of 54 financial instruments was processed, covering a wide spectrum of types of financial instruments (equity, debt, social bonds and a mixture of each), channels of intermediation (fund manager, banking-like organizations, crowd-investing, etc.) as well as other parameters (sources of financing, lifecycle of target company, investment tickets, etc.).

The geographical scope covers a large number of European countries (13) that represent a total population of more than 250 million people. Therefore, it can be assumed that the mapping offers an accurate picture of the financial instruments targeting *social enterprises*, albeit not 100% comprehensive, since some information was not available and some instruments were still in their development phase, with no data on their performance. The list of instruments analyzed is shown in Annex B.

With the available information we have created a data base, with individualized information on each instrument, with which relevant statistics have been generated that have provided an empirical basis to draw our final conclusions.

To elaborate these statistics we have chosen 8 fields, on the basis of which the 54 financial instruments have been analyzed: legal status, geographic scope, country, type of financial instrument, origin of funding, European Union sources, state aid and size of investment.

In the following charts, financial instruments (FIs) have been analyzed from different points of view (geographical scope, country, type of instrument, intermediaries, etc.), in order to draw conclusions to better understand the current market situation and the success factors behind positive results -whenever such is the case-. The survey explores two possibilities: a) instruments funded to some degree (percentage) with ESI; and b) instruments without European funds.

ⓑ A broad view of Social Impact Investments (SII): current situation and future expectations

Social impact investment (SII) provides finance to organisations with the explicit expectation of a measurable social as well as financial return (“*blended risk-adjusted financial and social returns*”).

International aid agencies, in particular, are searching for new tools, including results-based financing, outcome-based approaches or “*pay for success*” instruments, market-based solutions as well as various forms of public-private partnerships.

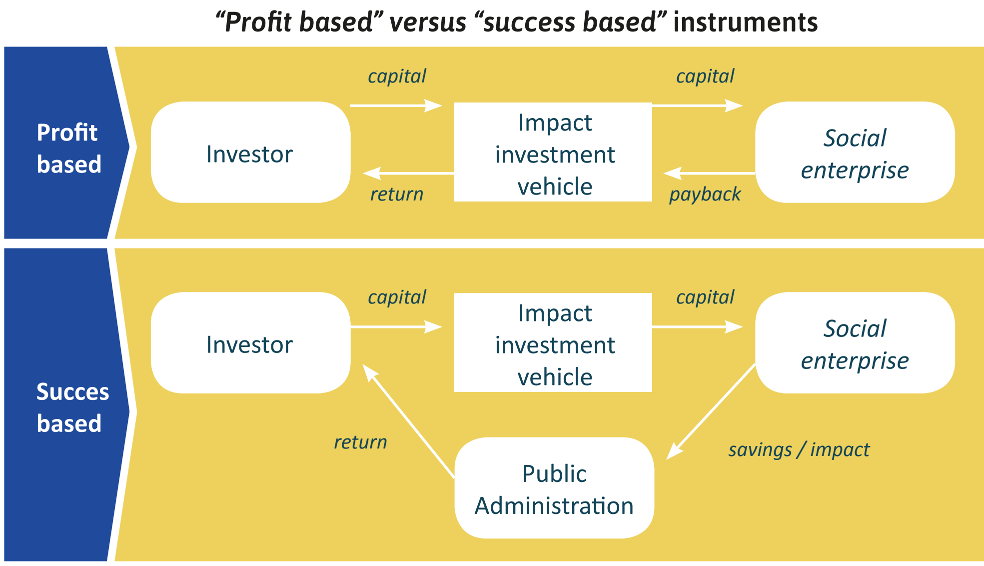
While the *social impact investment* market has grown significantly, drawing increasing attention, it is still in the early stages of development and represents only a small share of the global capital markets.

In the period 1997-2007 microfinance has grown at a rate of approximately 40% yearly in quantity of clients. The Monitor Institute and J.P. Morgan estimate that in the next two decades the *social impact investment* market will experience a similar annual growth rate.

A survey by J.P. Morgan and GIIN on the motivations of (traditional) investors in allocating capital to *social impact investments*, ranks them as follows:

- (Score 85) *“They are part of our commitment as a responsible investor”*
- (Score 69) *“They are an efficient way to meet our impact goals”*
- (Score 44) *“We are responding to client demand”*
- (Score 34) *“They provide an opportunity to gain exposure to growing economic sectors and geographical areas”*
- (Score 33) *“They are financially attractive relative to other investment opportunities”*
- (Score 13) *“They offer diversification to our broader portfolio”*
- (Score 2) *“We do so to meet regulatory requirements”*

Figure 26: ***Two different models of financial instruments for impact investments.***



Source: Own elaboration.

Figure 27: ***Social Impact Investments ecosystem.***

Social Needs

Ageing, Disability, Children & Families, Public order & Safety, Housing, Unemployment

Demand side			Supply side	
Impact seeking purchasers	**Impact driven organisations**	**Financial Instruments**	**Channels of impact capital**	**Sources of impact capital**
• Government procurement of services • Government as commissioner of outcomes • Foundations as commissioners of outcomes • Socially minded consumers of goods and services • Socially minded corporate purchases of goods and services	• Grant-relient organisations (charities) • Grant-funded organisations with trading activity • Social Enterprises / profit constrined organisations • Profit with purpose business • Cooperatives / Mutuals	• Secured loans • Unsecured loans • Charity bonds • Social impact bonds • Quasi Equity • Equity • Catalytic equity • Grants	• Social banks • Community development finance institutions • Impact investment fund managers • Impact investment intermediaries Commercial banks • Exchange platforms (crowd-funding) • Public agencies	• Government • EU-investment (ESI Funds) • Social investment wholesaler • Charitable trusts and foundations • Institutional investors • Family offices / High net worth individuals • Mass retail

Enabling Environment

Social systems, Tax laws, Regulatory environment, Financial market development

The success of instruments related to social impact investment depend on the correct composition / configuration of the different stakeholders (investor, investees, intermediaries), all with varying interests and motivations as well as its adaption to the framework conditions.

Source: Own elaboration adapted from OECD (Social Impact Investment, Building the Evidence Base).

I.- Social Impact Bond (SIB): an introduction

SIBs are the fastest growing financial instruments in recent years. First used in the UK and other anglo-saxon countries, they have spread quickly to a large number of countries, in and outside the European Union.

It is a convenient instrument for public administrations, since they allow for payments tied to positive results, and in proportion to the savings in social spending.

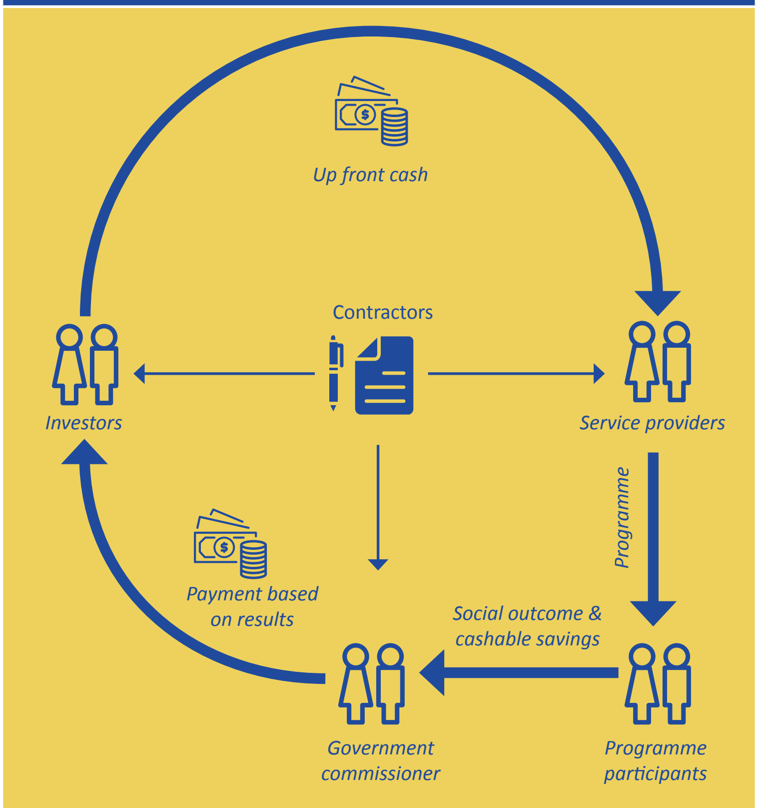
In addition, they have led to significant investments in innovation by private investors, creating in a very short time an ecosystem of specialized financial intermediaries, *social enterprises*, private investors and public administrations.

It has become a useful tool for public administrations to advance or *test* social policies. SIBs allow for one-off tests on a specific sector or social group. If the stated objectives are achieved, the administration can proceed to include the tested strategies or methods in their set of permanent public policies.

There is also some controversy, as some results can only be secured in the long term (years or decades), so it is never 100% certain or fully proved that the objectives set out in the SIB have been met.

Figure 28: ***Structure and main traits of SIBs.***

Stakeholder of the SIB model



Key drivers for developing a SIB

- **Innovate:** enabling new solutions to be tried and the risk of failure to be transferred to social investors.
- **Improve:** achieving better results from existing services.
- **Align:** correcting existing perverse incentives and focus outcomes.
- **Co-ordinate:** bringing stakeholders together to solve complex issues.
- **Unlock:** creating future savings by shifting the focus on prevention and investing up-front.

Adequacy for a SIB

- Desired outcome is clear and measurable (for example reducing recidivism).
- Quality of outcomes can improve.
- Desire to increase evidence of effective programs.
- Government is looking to transfer financial risk.
- Desire to catalyse the market for innovative financing.
- Large proportion of savings are cashable or funding is available for this outcome.

Source: UK Goberment.

When the public authorities decide to face a social action on a certain group, they design an action program defining the social results and quantifying the necessary financial resources. One of the possible options to supply these resources is through the SIBs, the figure above shows the model of operation of these.

In the diagram on the left, the first thing that should be highlighted is that the whole model pivots on a contract that articulates the relationship between four agents that make up the structure of a SIB: Private investors, Service providers, Government Commissioner and Contractor (manager), It assumes the management of the contract and ensures the achievement of its objectives.

The monetary flows between the different actors are represented with thick curved arrows, while the straight lines reflect the flows of activities, results and savings obtained between the contract agents and the final beneficiaries of the entire structure.

Lastly, it should be noted that there is no direct interaction between the final beneficiaries and the fund's investors.

ⓒ Social investments players

There are many players within the ecosystem that, in a few years, has been created around investment in the social sphere or *social impact investment*.

This ecosystem is formed mainly by:

- **The public administrations involved** (EU, national and regional governments).
- **Financial entities** (commercial banks and ethical banks).
- **Funds and risk capital managers** (philanthropic funds, patient capital, managers specializing in social finance).
- **Foundations.**
- **Consultants specializing** in the social field; accelerators and incubators.
- **Social enterprises** (limited companies, cooperatives, mutual societies, etc.).

Figure 29: ***Social investment players in Spain and Italy.***

	Spain	Italy
Public provider	• **Instituto de Crédito Oficial (ICO).** State owned credit institution (finance agency). The ICO provides loans via two mecanisms: direct funding (large companies) and second floor facilities via retail banks to SMEs. The ICO foundation invests in the field of social finance (i.a. entrepreurship, self-employment). • **ENISA** (Innovation National Enterprise). State owned credit institution to finance (participatory loans) innovative start-ups. One dedicated credit line for *social enterprises*. • **Agencia IDEA / SOPREA (Andalusia).** Public financing agency with geographic scope in Andalusia that bundles the investment activities of the regional government for andalusian enterprises with 1,1 € bn under mangement. Two dedicated funds for social economy: Fund for Sustainable Economy (50 € M) and Fund for Self-Employment (50 € M).	• **Ente Nazionale per il Microcredito** (national microcredit institution). Public, non-economic entity with important functions in the field of microcredit and microfinance at national and international level. • **Cassa Depositi e Prstiti CDP** (controled by Ministry of Economy and Finance). First "*social bond*" launched in the international capital market by an italian issuer (€ 500 M social bond) to support SMEs located in economically deprived areas or hit by natural disasters.

	Spain	Italy
Private provider	• **Creas Fondo Social SL.** Pioneer for social imapct investing in Spain. Creas manages two equity funds Seed Capital (Creas Inicial) and Later Stage (Creas desarrolla). • **ISIS Capital.** It is the investment arm of the ISIS foundation. The aim is to finance initiatives of social innovation. ISIS Capital manages two funds: one for projects in Spain and one for projects in developing counties. Measurement of perfomance with SROI (Social Return of Investment). • **Foundations of banks and savings banks.** Various foundations of banks and (former) saving vanks have deployed microfinance activities and offer support for social entrepreneurship: e.g. BBVA Microfinance Foundation, LaCaixa Microbank, KutxaBank, Grupo Operativo Cajamar. • **Coop57.** Cooperative bank that consists of a network of 540 *social enterprises* and more than 2.700 physical persons which deposit their savings in Coop57 to be invested in *social enterprises*.	• **Etica Sgr** (asset manager) is the asset management company of Banca Etica Group, founded in 2000. Since 2003 it is developing, promoting and managing exclusively socially responsible investments with the goal of "*representing ethical values in the financial markets, making financial players aware of SRI and CSR values*". • **Oltre venture** (investment fund) is a company of social venture capital, born in 2006 from the experience of Fondazione Oltre, the first Italian foundation of Venture Philanthropy. Investments in risk capital of enterprises which promote social innovation. The main areas of intervetion concern access to credit, social-health housing, work in depressed areas, as well as training and relational goods in general. • **Investire Sgr** (asset manager) is a leading independent asset manager specialized in actively managing real-state portfolios in different market sectors, and today a key investment partner for the italian market. Investire is the first italian asset management company to have launched ethical real-estate funds dedicated to social housing. • **Credito cooperativo** is a network comprising 313 cooperative banks (called Banche di Credito Cooperativo, Casse Rurali, Casse Raiffeisen in Alto Adige), associative structures, and several service companies, all of which work together to guarantee a complete and diversified range of products, in keeping with the values and identity of a cooperative. • **Banca Sella** manages one of the first Impact Investment Funds in Italy, "*Investimenti Sostenibili*". This fund adopts a comprehencive ESG (Enviromental, Social and Governance) integration strategy intended to reach a high social and enviromental impact. • **UBI Banca.** In 2010, the UBI Banca Group created an organizational unit named "*Enti, Associazioni e Terzo Settore*", dedicated to the management of relationships with non-profit clients. Instruments: "*UBI Comunitá*", a platform of services and tools dedicated to third sector and religious organizations. "*Social bond UBI Comunità*", obligations issued by UBI Banca Group that can be quoted at MOT (*Mercato delle Obbligazioni Telematiche*).
Social Banks	• **Fiare** is the spanish agent for the Italian Banca Popolare Etica, S. Coop (Banca Etica). Operations in Spain since 2005. • **Triodos Bank** is one of the world's leading sustainable banks ("*impact first*"). The mission is to make money work for positive social, environmental and cultural change. Product range: saving accounts, payments, lending and investments for personal and business banking customers.	• **Banca Etica** (created in 1999), represents the first institution of ethical finance in Italy: financing organizations operating within the third sector which carry out socially oriented economic projects, having the legal form of cooperative societies, associations or social institutions. • **Banca Prossima**, created in 2007 by the Intesa Sanpaolo banking group. First European bank with the exclusive aim of providing financial support to *social entreprises*. Specific credit rating system for non-profit organisations. In recent years the bank promoted two instruments dedicated to the non-profit world: *Terzo Valore* (third value) and TRIS which is the first experiment with a Social Impact Bond.

Source: Own elaboration.

d State of the art of financial instrumentss

We proceed to classify the various instruments which currently finance *social enterprises*, in order to assess: a) their suitability to contribute financially to these projects; and b) the feasibility of their implementation.

The survey of these financial instruments (FI) has focused on:

- Stage of development.
- Implementation capability of regional agencies.
- Innovation level of the FI.
- Origin of resources: public, private, FEDER, FSE...
- Risk level assumed by investors.

The survey segments the FIs into 6 categories:

I.- LOANS

UNSECURED LOANS

An unsecured loan is not tied to any of company's assets and the lender cannot automatically seize your property as payment for the loan.

SECURED LOANS

Secured loans are loans that are backed by an asset. This asset is collateral for the loan. When you agree to the loan, you agree that the lender can take possession of the collateral if you don't repay the loan as agreed.

LOANS WITH MENTORING AND ACCOMPANIMENT

Loans linked to an accelerator entrepreneur program or a business school program (the company receives the loan only if they follow the program).

WITH PAYMENT PROTECTION PLAN (PPP)

A *PPP* is a type of insurance offered by lenders that lets a customer stop making minimum monthly payments on a loan during a period of involuntary unemployment or disability; and if the borrower passes away, automatically cancels the balance owed.

PEER-TO-PEER LENDING

Peer-to-peer lending (also crowdlending) is a method of debt financing that enables individuals to borrow and lend money without an official financial institution acting as an intermediary. Peer-to-peer lending removes the middleman from the process, but it also takes more time, effort and risk than the general brick-and-mortar lending scenarios.

II.- GUARANTEES

A loan guarantee, in finance, is a promise by one party (the guarantor) to assume the debt obligation of a borrower if the borrower defaults. A guarantee can be limited or unlimited, making the guarantor liable for only a portion or all of the debt. On bank loans. On shareholder loans. On participatory loans.

III.- EQUITY / QUASI-EQUITY

VENTURE CAPITAL FUNDS

Venture capital funds are investment funds that manage the money of investors who seek private equity stakes in start-ups and small to medium-sized enterprises with strong growth potential. These investments are generally characterized as high-risk/high-return opportunities.

INVESTMENT CROWDEQUITY

Investment crowdfunding is a way to source money for a company by asking a large number of backers to each invest a relatively small amount with it. In return, backers receive equity shares of the company.

PARTICIPATORY LOANS

A participative loan is a financial instrument that is placed in an intermediate position between a long-term loan and the taking of shares in the capital of the company. Its main characteristic is that the remuneration always has a variable part depending on the evolution of the company, and may have another fixed part. The parameters on which the variable part will depend are agreed by the parties, the most common being sales and EBITDA. The participative loans that have a lower priority than the ordinary ones, are subordinated debt, they are considered part of the net worth of the companies and they are a very used instrument for the financing of companies in their initial phases.

CONVERTIBLE NOTES

Convertible notes are structured as loans with the intention of converting into equity. The outstanding balance of the loan is automatically converted to equity at a specific milestone, often at the valuation of a later funding round. In order to compensate the angel investor for the additional risk of investing in the earlier round, convertible notes will sometimes have additional clauses, such as caps and or discounts.

SOLIDARITY ACTIONS

These are social enterprises that create partnerships with solidarity actions to launch social impact projects. In addition, they often launch solidarity exchanges that allow for the existence of a secondary market that generates liquidity for investors.

IV.- SOCIAL IMPACT BONDS (SIBs)

A social impact bond (SIB) is a contract with the public sector or governing authority, whereby it pays for better social outcomes in certain areas and passes on part of the savings achieved to investors. A social impact bond is not a bond per se, since repayment and return on investment are contingent upon the achievement of desired social outcomes; if the objectives are not achieved, investors receive neither a return nor repayment of principal.

PAYMENT BY RESULTS

Payment by results (PBR) is a form of financing that makes payments contingent on the independent verification of results -that is, payments are made after the achievement of pre-agreed results, rather than being made up front to fund future activities-.

V.- MICROCREDITS

These are loans of a very low amount –between 500 and 5.000 €– destined to the beginning of some economic activity and granted to people in financial exclusion situations –i.e.: people who would never otherwise have access to a traditional bank loan–. Normally, no collateral is requested to guarantee the loan, only a personal or a collective guarantee.

VI.- CROWDFUNDING

There are a multitude of financial instruments under the “crowd” formula, such as crowdfunding, crowdlending or crowdequity. In all cases, it is a collaborative project financing mechanism, where the traditional financial intermediary is replaced by a platform that allows the applicant of funds to be directly connected with a multitude of donors, borrowers, investors, etc.

e Chart of financial instruments

Financial instruments (FIs) have been analyzed in the following chart from different points of view (geographical scope, country, type of instruments, intermediaries, etc.), so as to draw conclusions to better understand the current market situation, as well as the success factors when the FIs have brought positive results. The survey explores two possibilities: a) instruments funded in some percentage with ESI; and b) instruments without European funds.

Figure 30: ***Key findings on financial instruments, as analyzed by project partners.***

Geographic Scope		
Parameter	with ESI	without ESI
Regional	71%	23%
National	29%	63%
Supra-national	0%	15%

Type of Instrument		
Parameter	with ESI	without ESI
Equity /quasy equity	7%	43%
Loan	36%	20%
CrowdXXX	0%	5%
Microcredit	21%	13%
Guarantee	14%	5%
SIB	0%	5%
Others	21%	10%

Country		
Parameter	with ESI	without ESI
Spain	0%	40%
Italy	36%	28%
France	7%	5%
UK	7%	10%
Germany	7%	5%
Portugal	7%	0%
Poland	14%	0%
Denmark	7%	5%
Others*	14%	8%

*Other countries: Belgium, Netherlands, Slovenia, Lithuania, Finland.

State Aid Scheme		
Parameter	with ESI	without ESI
Yes	71%	23%
No	29%	78%

Intermediary		
Parameter	with ESI	without ESI
VC manager	7%	35%
Ethical bank	0%	10%
Foundation	21%	13%
Commercial bank	29%	20%
Public entity	14%	13%
Others	29%	10%

Investment Ticket		
Parameter	with ESI	without ESI
<10k	14%	5%
(10-25k)	21%	8%
(25-50k)	29%	3%
(50-100k)	7%	13%
(100-200k)	7%	5%
>200k	0%	28%
Not specified	21%	40%

Public (Co-)Funding		
Parameter	with ESI	without ESI
Yes	100%	45%
No (100% private)	0%	55%

Investment Phase		
Parameter	with ESI	without ESI
Early Stage	57%	28%
Later Stage	7%	25%
Indiferente	36%	48%

Source: Own elaboration, base on research data from project consortium.

The key ideas derived from this analysis are:

- There is a clear difference between countries when using ESI funds for the instruments surveyed (e. g.: in Spain they are not used).
- When ESI funds are used for financial instruments, they are usually debt; whereas if they are not, they tend to be equity, possibly due to the difficulty / ease in their implementation.
- The previous point tells us that in order to manage debt derivative products, public intermediaries, commercial banks or foundations are chosen; for equity, however, it is usual to turn to VC managers.
- When there are ESI funds in a financial instrument, there are usually no private co-investors.
- Instruments with ESI funds tend to finance low quantity tickets in companies in seed or newly created stages; whereas when these funds do not exist, the tickets tend to be larger and for companies of larger age and dimension.

Figure 31: ***Heat map: market penetration by country of financial instruments for social enterprises.***

Countries (selection)	Financial Instruments (selected) targeting *social enterprises*						
	SIB	Other payment for success/ impact instruments	Equity / quasi equity / VC	Loan schemes	Guarantee schemes	Microfinance	CrowdXXX / Club / other P2P mechanisms
Spain							
Italy							
France							
Germany							
UK							
USA							
Other	Developing countries: South America, Sub-Saharan Africa, Middle East. Developed countries: Canada, Israel, Australia					Worldwide	

Source: Own elaboration.

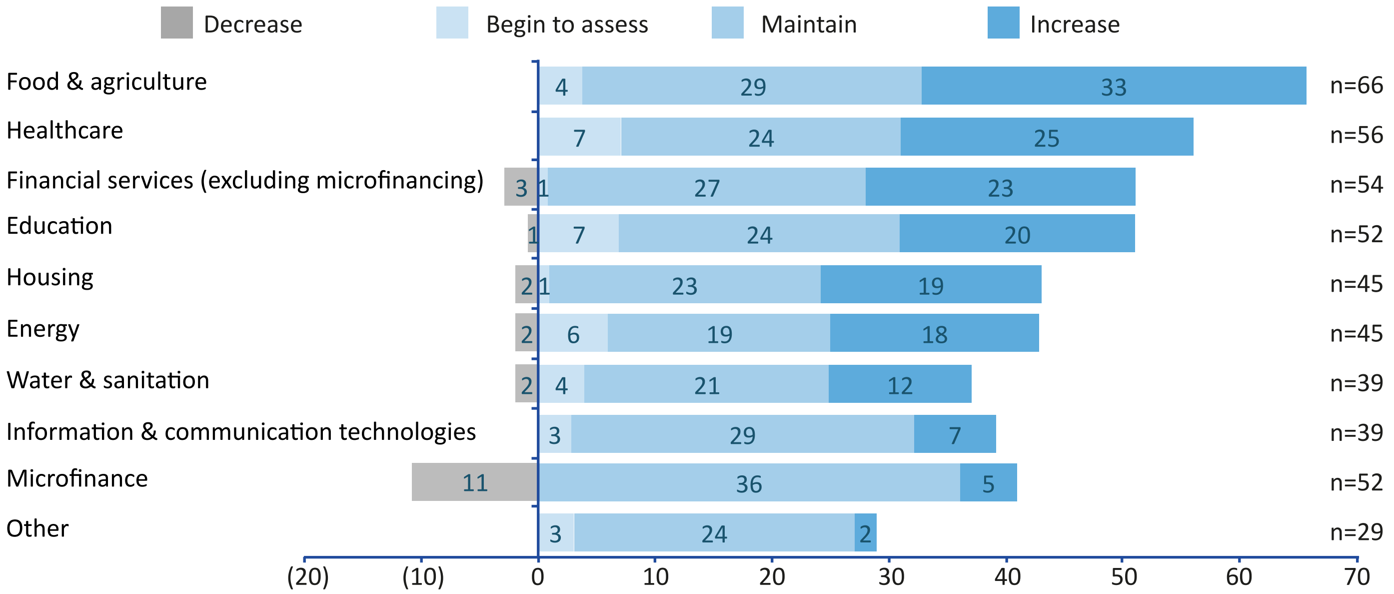
After this analysis of the market penetration, by country, of each type of instrument, a clear conclusion stands out:

"In the anglo-saxon countries, the tendency goes towards "*pay for results*" products, mainly SIBs; while in the other European countries debt-based products are more frequently used".

I.- Allocation of social investments by sectors

The following chart shows the top sectors receiving funds destined to investment and financing in the social sphere, coupled with a key indicator: which sectors are growing as recipients and which are clearly declining (e.g.: microfinance).

Figure 32: ***Where is social investment going: main recipient sectors.***

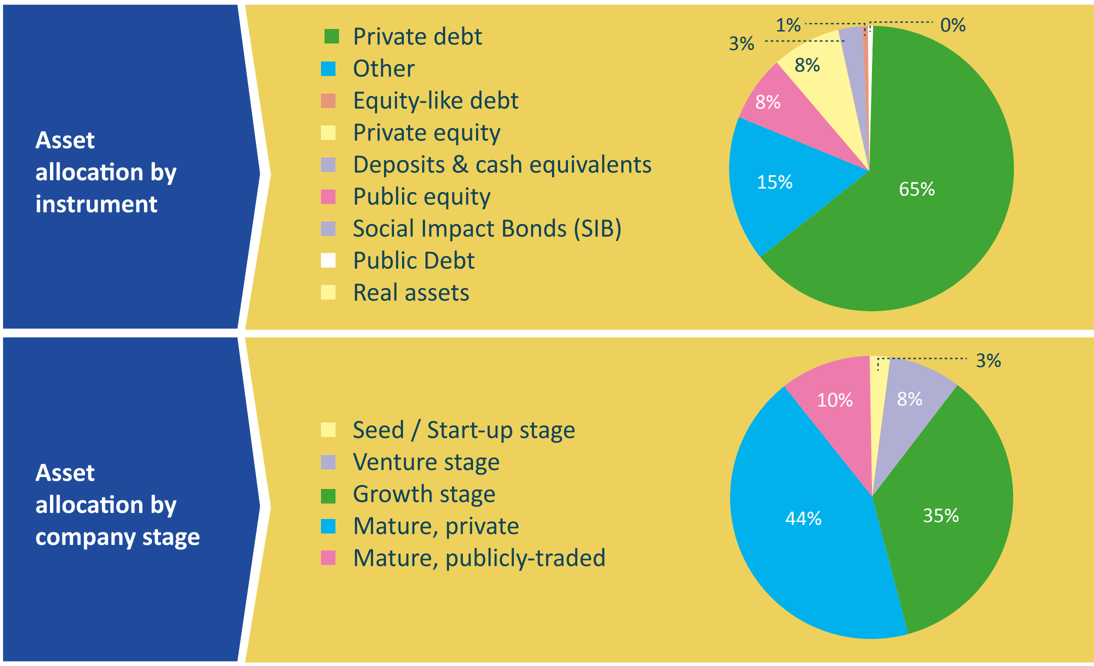


Source: GIIN, J. P. Morgan.

The survey has also studied how funds are structured according to the type of instruments used, clearly highlighting the importance of private debt.

With regards to the phase/stage of the company at the time of the investment, the focus on the growth stage and subsequent stages is definitely clear

Figure 33: ***Asset allocation by type of instrument and company stage.***



Source: GIIN, J. P. Morgan.

II.- Key parameters to select the type of financial instrument needed

The following chart sets out some basic ideas to help make a better selection of financial instruments, in view of the mapping exercise we have gone through.

Figure 34: ***Recommendations: how to select the most adequate financial instrument.***

Company lifecycle	• The financial needs of the companies change in accordance to their lifecycle. • Main stages to be differentiated: early stage (seed, start-up) and later stage (consolidation, expansion).
Type of private co-investor	• The instrument has to respect the different interests and motivations of private co-investors: foundations, family offices/HNWI, institutional investors, retail etc. • Not all instruments are suitable for any particular investor, and not all investors are represented in the region/country or can be activated.
Size of instrument / budget availability	• Financial instruments need a critical size to be viable (management costs must be borne). • However, the financial budget is often limited and has opportunity costs.
Type of social company and its business model	• The level of market orientation of the business model and the type of *social enterprise* (*impact only, impact first, financial first*) determines the eligibility of the financial instrument. • There is a risk of limited market size (scarcity of target companies) in some target segments. • The legal form of the target companies (and its implications). may also be a restriction for the eligibility of instruments
Type of intermediary	• The majority of financial instruments for *social enterprises* require a specialized approach. • There may be a lack of qualified financial intermediaries to deliver the service, in particular regarding instruments with limited geographic scope. This may be a criteria for exclusion of certain financial instruments.

Source: Own elaboration.

III.- Making sense of Social Impact Bonds (Sis)

Due to the special attention SIBs are getting in recent years, 138 instruments of this type have been studied, inside and outside the EU. From this exercise some important conclusions stand out:

- **The amounts involved in the SIBs are still small** (mainly in the EU area), which makes management costs proportionally high.
- **The investment periods are short,** which makes it difficult to make a real measurement of the results of its implementation, since they are usually visualized only in the medium and long term.
- **They are mostly destined to projects of local or regional scope**: this is basically due to the geographical scope the public entity behind them; and also because of the greater facility for measuring the social impact in a small and controlled area.
- **In developing countries, they invest mainly in education and health;** while in developed countries they focus on areas such as employability, youth or housing.

Figure 35: ***Relevant findings in relation to Social Impact Bonds (SIBs).***

Size of instrument (Millions €)	Distribution
[0-1]	15%
[1-2]	19%
[2-5]	36%
[5-10]	11%
[10-20]	13%
[20-XX]	6%
Total	100%

Investement period (years)	Distribution
[0-2]	6%
[2-3]	31%
[3-4]	28%
[4-5]	13%
[5-6]	9%
[6-XX]	13%
Total	100%

Social Issue	Developing Countries	Developed Countries
Employment	3%	16%
Youth employment	3%	11%
Education	26%	8%
Health	29%	8%
Agriculture / Rural development	16%	1%
Children care	10%	11%
Refugees / Migrants	6%	3%
Housing	0%	18%
Social assitance	6%	8%
Recidivism	0%	12%
Total	100%	100%

Geographic Approach	%
Local	54%
Regional	31%
National	12%
Transnational	2%
Total	100%

Statistically, the “typical” Social Impact Bond has a local or regional scope, a size of 1-5 € Millions with an investment period of 2 - 4 years. The social target depends on the development level of the country. While developing countries prioritize education and health, developed counties focus mainly on (un)employment, housing, recidivism and children’s care and health.

Source: Own elaboration, based on Istigio data.

CONCLUSIONS

Analysis of Supply / State of the Art of Financial Instruments

- Social Impact Bonds (and other "payment by results" instruments) have emerged in recent years, particularly in the UK.
- However, they are:
  - Only suitable for very concrete problems.
  - Have significant implementation and management costs.
  - There is no evidence yet of a link between "theory of change" and long term social impact.
  - Difficulty in measuring impact and savings.
  - Possible incompatibility with public funding sources (accounting rules –Spain and Italy– and justification/verification procedures of ESI Funds).
- In general, there are few innovative practices with a specific incidence in social enterprises. Standard financial instruments, socially labelled, predominate.
- Social venture capital: the fundamental issue is shortage of high quality investment opportunities.
- Instruments targeting early stages need combine capacity building and post investment support.

06

ASSESSMENT OF STATE
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06. GENERAL CONCLUSIONS AND ADDITIONAL CONSIDERATIONS

POTENTIAL GROWTH AND FINANCING NEEDS FOR AN EMERGING SOCIAL SECTOR

There is significant potential in developing effective *financial instruments* (FI) for the social sector. But countries with a clear legal definition of *social enterprise* (SEs) tend to have a stronger social sector and will enjoy an advantage.

Main drivers of the emergence of *social enterprises:*

- Shrinking welfare state/ withdrawal of state intervention => necessities of citizens must be satisfied by market forces or civil society.
- Digitalisation enables scalability of social business models.

SEs need to focus on their main *sectors of activity* – social care, healthcare, education, *worker integration social enterprises* (WISE)– and *social targets* –the unemployed, people with disabilities, minority ethnics groups, those at risk of social exclusion, etc.– to attract investment/finance.

An effective FI for social enterprises must adapt to different types of targeted organisations. A "*one size fits all*" instrument will not do.

Two ways to develop the financial instruments (FI) that fit the needs of SEs:

- Using *conventional instruments* to finance normal societal legal forms.
- Developing *specific financial instruments* that enhance all possible social goals and vehicles of social action, such as the *Social Impact Bond* (SIB).

MEASUREMENT IS KEY

To attract social impact investment (SII) measurement is key, as it drives behaviour: "*you get what you measure*". All known measuring methods (Impact Value Chain, Theory of Change, Logical Model) follow five steps: a) planning / setting objectives; b) engaging & analysing stakeholders; c) setting relevant measures; d) measuring, validating and valuing; and e) reporting, learning and improvement. Effective measurement of SII must be: *relevant&helpful, simple, natural, certain, understood & accepted, transparent & well explained and founded on evidence.*

OBSTACLES TO FINANCING FOR SES

Access to finance during the whole company lifecycle is the key constraint for the development of *social enterprises*. Their reliance on the public sector raises questions of sustainability. Mainstream banking solutions provide no adequate response, for three reasons:

- **Risk**: perception of high risk with no collateral.
- **Return**: high transaction costs for expected below-market returns.
- **Impact**: positive externalities are not taken into account.

WHAT THEY HAVE NOW

Most common sources of finance for SEs: equity, prizes and 3Fs. Usability of FIs is inversely proportional to difficulty of access. The most recommended financing methods for SEs are:

- Self financing
- 3Fs, crowdfunding and prizes
- Grants and mezzanine
- Venture capital

Regardless of the SE's lifecycle –*seed/start up and scaling/expansion*– "*alternative*" and "*equity/quasi-equity*" instruments are the most desired. They need further development.

SOCIAL IMPACT INVESTMENT AND SIBS

Social Impact Investing (SII) is increasingly mainstream. Investors are forcing a "*double bottom line approach*" (financial returns + social returns) in their investment decisions. For social impact investors, the lack of capacity building in *social enterprises* (particularly in early stages) is a key obstacle.

Social Impact Bonds (and other "*payment by results*" instruments) have emerged in recent years (particularly in the UK). However, they are:

- Only suitable for very concrete problems.
- Have significant implementation&management costs.
- Show no evidence of a link between "theory of change" and long term social impact.
- Difficult in measuring impact and savings.
- Possibly incompatible with public funding (accounting rules -Spain and Italy- and verification procedures of ESI Funds).

FEW INNOVATIVE PRACTICES

In general, there are few innovative practices with incidence in social *enterprises*.

- Standard financial instruments, socially labelled, predominate.
- Social venture capital: the issue is shortage of quality investment opportunities.
- Instruments targeting early stages need to combine capacity building and post investment support.

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Be advised of disposal of additional statistics data of performed surveys/market analysis by the consortium partners. In case of consultation contact: Agencia IDEA

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IFISE Innovative Financial Instruments in support to the Social Economy

Agencia de Innovación y Desarrollo de Andalucía IDEA
CONSEJERÍA DE ECONOMÍA, CONOCIMIENTO, EMPRESAS Y UNIVERSIDAD

Sevilla, July 2018