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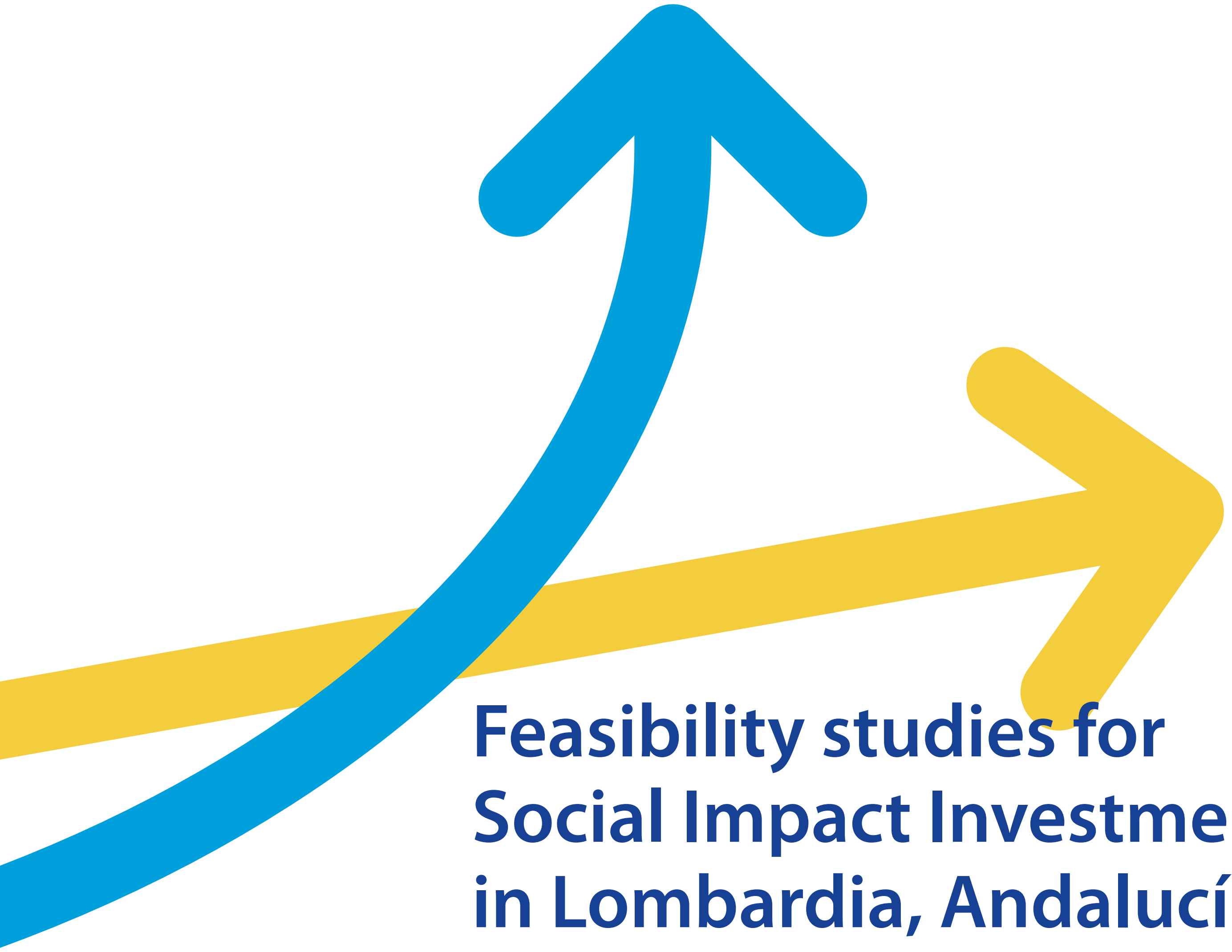
IFISE Innovative Financial Instruments in support to the Social Economy



Feasibility studies for Social Impact Investment in Lombardia, Andalucía, Comunidad Valenciana and Piemonte

Executive Summaries

Summary

Social Impact Bond in Lombardia

Market Study

Potential SIBs Public Sector Commissioners

SIBs can only be deployed *at regional level* under the following pre-condition:

The Regional Government and, in particular, its regional public administration institutions must be directly responsible for the implementation of the public policies targeted by those SIBs, including budget allocation and contracting decisions.

In Lombardia, each Regional Minister ("Assessori") is directly responsible for a specific regional public policy area and for a Directorate General (DG) implementing that particular policy.

LOMBARDIA – REGIONAL MINISTRIES AND DGs
(public policy areas)

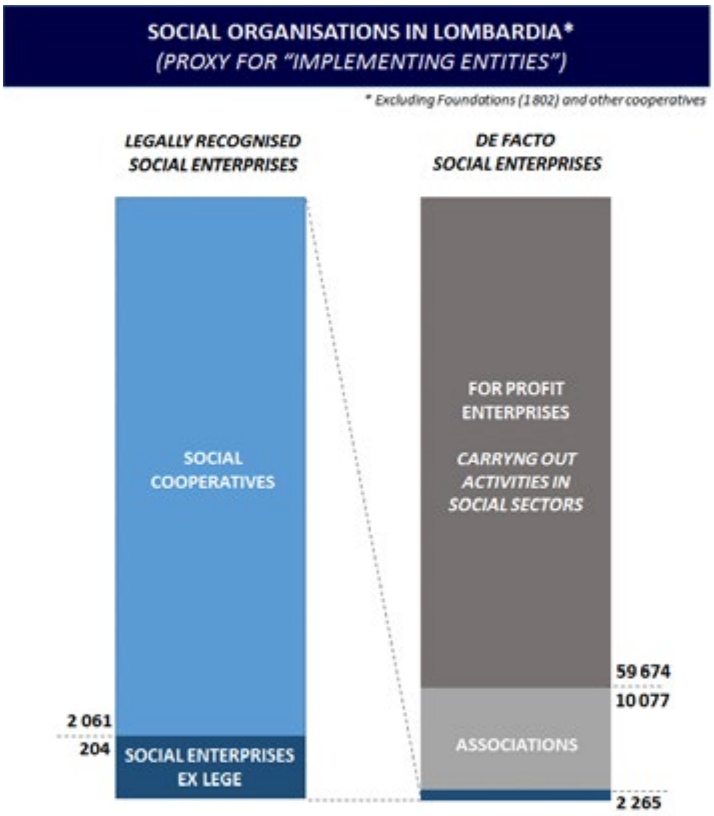
1. Agricolture, Suppy and Green Systems
2. Budget, Finance and Simplification
3. Enviroment and Climate
4. Autonomy and Culture
5. Local Authorities, Mountain and Small Municipalities
6. Infrastructures, Transportation and Sustainable Mobility
7. Education, Training and Employment
8. Policies for the Family, Parenthood and Equal Opportunities
9. Social, Housing and Disability policies
10. Safety
11. Sports and Youth
12. Economical Development
13. Civil Protection
14. Tourism, territorial Marketing and Fashion
15. Research, Innovation, University, Export and Internationalization
16. Welfare

The Lombardia budget (approx. € 2 billion for the 2019-2021 timeframe) is also allocated to specific objectives ("Missione") that broadly match these regional public policy areas. Furthermore, Lombardia regional ESF and ERDF Operational Programmes (OPs) also target the same public policies, with DGs acting as intermediate bodies for the corresponding management authorities (MA). In the 2014-2020 programming cycle, ESIF accounted for approx. € 2 billion financing.

In conclusion, SIBs can be implemented at a regional level in Lombardy in any of the abovementioned public policy areas, with Regional DGs acting as Public Sector Commissioners. However, there are still gaps in terms of SIBs awareness amongst regional public authorities. Together with short budget cycles and limited scope for public sector innovation and experimentation, it may hinder the adoption of this type of more innovative financing mechanisms.

Potential SIBs Implementing Entities

SIBs deployment requires the existence of a pool of innovative social organisations to implement the interventions leading to the contracted outcomes.



Source: IFISE Project – Instat, Infocamere, CMCP-Consult analysis

In spite of its strong territorial presence and the undeniable positive social impact of its activity, as well as of a growing number of ongoing initiatives focusing on social innovation and social entrepreneurship, Social Economy in Lombardia as a whole is still in an early stage of development in what concerns impact investment, not often having the opportunity to test and to adopt complementary non-mainstream approaches.

Moreover, most organisations still do not systematically measure the results and impact of their projects and interventions, which in turn are then not considered "investable" by the limited but growing number of social and impact investors. Furthermore, there is still legal uncertainty on the definition and scope of "social enterprise", that will probably be overcome with the application of so-called Third Sector Code. In 2016, based on previous regulatory framework, only 204 Lombardia social enterprises were registered as such at the Chamber of Commerce (27% of the total number of social enterprises registered in Italy).

As a result, although market potential exists, the social organisations and projects that are already prepared to engage in impact investment initiatives do not create sufficient critical mass for the development and future sustainability of a SIBs Programme.

In fact, currently, in spite of several studies and ongoing projects focusing on SIBs[1], there is still no SIB project fully implemented in Italy. Furthermore, there are not many mechanisms in place for systematically identifying and/or promoting the "investment readiness" of new social innovation and social entrepreneurship projects.

Despite the positive evolution in the number of social organisations engaging in social innovation and social entrepreneurship projects in the Lombardy region, two main gaps hindering the implementation of SIBs can still be identified:

- Scarcity of "SIBs-ready" social organisations and projects;
- Scarcity of mechanisms to identify "SIBs-aligned" social organisations and projects and to improve its readiness to engage in a SIB's project.

Potential SIBs Social Investors

Lombardia is one of the Italian regions better positioned to attract social investors to SIBs.

In fact, approx. 30% of all Italian foundations are located in Lombardia. The second region in Italy with most foundations accounts for only 12%. Although foundations often make philanthropic investments outside their region of origin, this is a good indicator of latent supply for SIBs pre-financing social investments (i.e. for the provision of the initial upfront capital necessary for deploying a SIB).

Enterprise or family foundations represent by far the largest majority (more than 90%) of foundations in Lombardia, followed by community foundations. Banking foundations are a minority, but a very relevant one, as in recent years, especially following the financial crisis, they have gradually diversified their investments and strengthened their social role as philanthropic investors.

As across the EU and the rest of Italy, the majority of foundations and other philanthropic investors in Lombardia using donations as the preferred format for financing social organisations or projects.

There is however a small group of innovative impact-driven foundations, mostly banking foundations, already involved in more innovative social finance approaches.

Moreover, in recent years an emerging group of players has joined this still small number of entities performing impact investments. These new players mostly stem from intermediaries or social accelerators that have set-up social

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[1] Two examples being the efforts of Finpiemonte and the 2017´s SIBs feasibility study developed by Politecnico Milano, Universitá di Perugia and KPMG for the Human Foundations and Fondazione Sviluppo e Crescita (CRT)

impact funds initially to finance the social organisations and projects they advise, but are now starting to aggregate capital from other social investors or co-investing with them in a broader range of social innovation projects.

With a significant number of diverse philanthropic investors based in the region, there is a strong case for involving these players in the pre-financing stage of regional SIBs in Lombardia. Most of them, however, are still positioned in the more traditional grant/donation end of the social finance spectrum, with limited know-how on SIBs mechanisms.

A small group of social impact intermediaries (some of them already managing impact funds) is also emerging in Lombardia. Should this trend hold, it might help to create the ecosystem necessary for SIBs deployment.

Funding Gap

Being SIBs an emerging reality in most Member States, there is still not enough data to deliver a good quantitative estimate of the financial gaps associated with unmet potential demand and the abovementioned market failures. In this context, qualitative and benchmarking analysis may prove more useful.

Domains of application for a regional SIB in Lombardia (current gaps)

SIBs should address societal problems where innovative responses focused on prevention might complement and bring additional value added to the public policies currently being implemented, as well as working as a testbed for testing new approaches.

SIBs domains of application are increasingly becoming aligned with the UN SDG Framework, which encompasses a wide range of potential SIB's target social indicators and outcomes – quantified and broadly accepted.

Considering the different SDG indicators and metrics, the Lombardia region generally compares well with the other Italian regions, the country as a whole and even with EU28 average.

The following table identifies the few cases where room for improvement still exists and where SIBs could be successfully deployed:

GOALS, INDICATORS AND METRICS		RELATIVE POSITION			TREND	SIBs?
		IT	IT REG	EU28		
1 NO POVERTY	Absolute poverty	🟩		🟥	↓	✓
	families with children	🟥		🟥		
	Risk of poverty or social exclusion	🟩		🟥	↓	
	Poverty risk after social transfers	🟩		🟥	↓	
	Severe material deprivation	🟩		🟥		
2 ZERO HUNGER	Adult obesity	🟩			↓	✓
3 GOOD HEALTH AND WELL-BEING	Adults >65 living alone				↓	✓
	without support				↓	
	Chronical illnesses				↓	
	% smokers / % alcohol drinkers	🟥			↑	
4 QUALITY EDUCATION	School drop-out	🟩		🟥	↑	✓
	Tertiary Education	🟩		🟥	↑	
	PISA tests results	🟩		🟨	mixed	
5 GENDER EQUALITY	Employment ratio FEM/MASC	🟩		🟥	=	✓
	Women in management positions	🟩		🟥	mixed	
6 CLEAN WATER AND SANITATION	Per capita water consumption	🟥		🟥		✓
	Rivers and lakes (ecological indicators)		🟨			X
	Rivers and lakes (chemical indicators)		🟨			X
7 AFFORDABLE AND CLEAN ENERGY	Energy production from renewable sources	🟥	🟥	🟥		✓
8 DECENT WORK AND ECONOMIC GROWTH	Youth unemployment	🟩		🟥	↑	✓
	Youth participation in the labour market	🟩		🟥	↑	
	NEETs	🟩		🟥	↑	
9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	% R&D over GDP	🟥		🟥	↑	✓
10 REDUCED INEQUALITIES	Per capita net income variation 2008-2016	🟥	🟨			✓
	GINI index	🟥	🟨		↓	
	% income of the 40% poorest familes	🟩	🟨		↓	
11 SUSTAINABLE CITIES AND COMMUNITIES	% of low quality housing	🟥	🟥		↓	✓
	Pollution indicators	🟥	🟥	🟥	↑	
12 RESPONSIBLE CONSUMPTION AND PRODUCTION	% bio agriculture (soil occupation)	🟥	🟥	🟥	↑	✓
15 LIFE ON LAND	New forest	🟥	🟨		↓	✓
	Farmland bird index	🟩			↓	

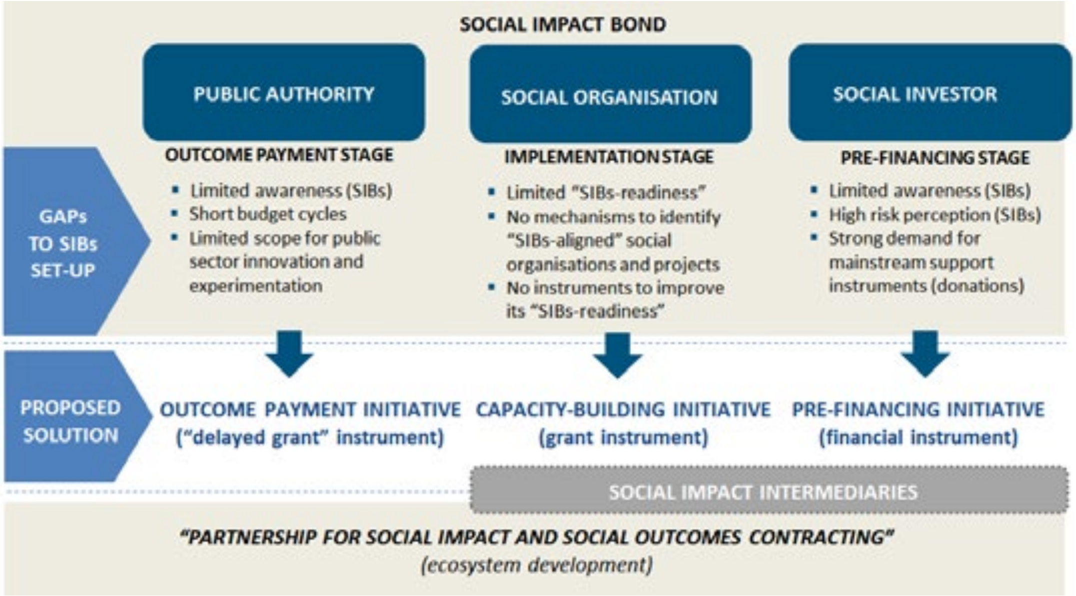
Source: *UN SDG DB, World Bank, EUROSTAT, PoliS Lombardia, CMCP-Consult analysis*

Financial Instrument

Based on the market analysis performed it is possible to conclude that Lombardia has very favourable initial conditions for SIBs deployment. However, several systemic gaps still need to be addressed in order to successfully deploy regional SIBs.

Therefore, at this early stage of market development, a stand-alone SIB pilot project would not be sufficient for triggering the adoption of SIBs in the region. It would also not have enough scale to contribute for the development of the necessary impact investing ecosystem.

Consequently, a systemic approach addressing the identified gaps hindering SIBs deployment in Lombardia might be a better option:



As designed together with FinLombarda, this approach would encompass 4 complementary but independent components, to be implemented together or separately, as stand-alone initiatives:

1. an outcome contracting-payment initiative, supporting Lombardia regional public sector authorities willing to engage into SIBs' projects, namely by taking over part of the corresponding outcome payments;

2. a capacity-building initiative providing targeted technical assistance support to social organisations implementing innovative social interventions. This initiative would focus on addressing two key aspects for SIBs deployment: i) improving the organisational, management and finance competencies of social organisations and teams directly involved in these social interventions; ii) building capabilities on social impact and social outcomes measurement. This initiative would not only constitute a screening instrument to identify innovative social organisations and projects, but would also act as a catalyser for an emerging market for impact measurement and capacity-building expert services, indirectly stimulating the development of the social impact ecosystem in Lombardia;

3. A pre-financing financial instrument contributing to reduce the risk of SIBs operations for social investors willing to provide the initial capital necessary for the set-up of regional SIBs in Lombardia. This initiative would also contribute to increase the financial resources available in the region not only for the set-up of SIBs projects but also for other social investment initiatives, indirectly contributing for the development of a social investment market in Lombardia;

4. a regional platform ("Partnership for Social Impact and Social Outcomes Contracting"), where the main regional stakeholders and experts that would gather periodically to discuss relevant matters for the development of a regional agenda and ecosystem for impact investing, incl. Social Outcomes Contracting (SOC) and SIBs.

The use of ESIF

In the specific case of Lombardia, both ERDF and ESF regional OPs might be used to finance the set-up and implementation of the systemic approach presented in the previous section.

Specifically, European Structural and Investment Funds (ESIF) could be used:

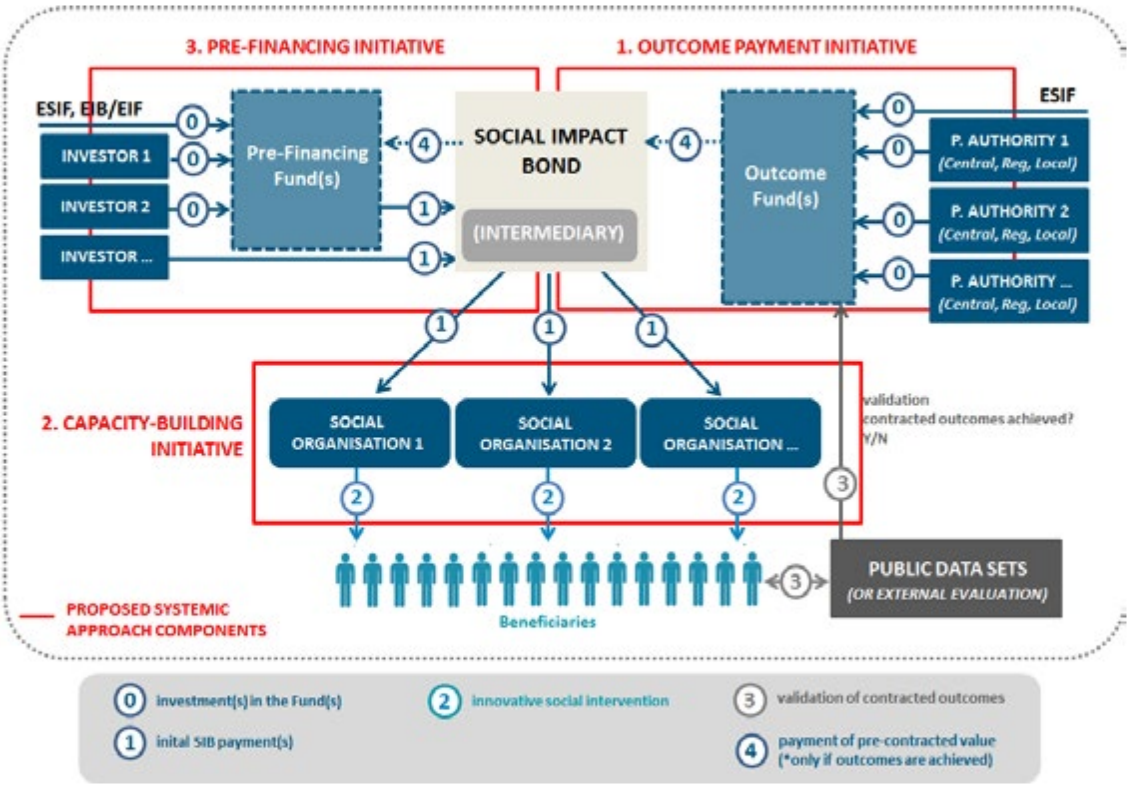
1. to finance the outcome contracting-payment initiative, in the form of "delayed grants" paying for SIBs validated outcomes. Following outcome validation, each payment would be made under a pre-contracted lump sum value, set per validated outcome. This can be done on a SIB-by-SIB basis or structured as an Outcome Fund, combining ESIF budget with several sources of Public Sector budget (e.g. from central, regional and/or local government). This last option should be used when setting up an integrated SIBs Programme, in order to achieve the necessary critical mass for the continuous deployment of SIBs portfolios over time.

2. to finance the capacity-building initiative, in the form of non-reimbursable support (grants) to finance initial capacity-building of social organisations and projects, not only reinforcing its SIBs-alignment, but also its readiness to take up social investment and to effectively deliver social impact . These grants might be provided either by reimbursing incurred and paid costs (real costs) or by paying a pre-agreed amount against the delivery and validation of a specific output directly resulting from the capacity-building process.

3. To finance the pre-financing initiative, in the form of a pre-financing Financial Instrument (FI), ideally structured as a Pre-Financing Fund, providing the initial capital necessary for SIBs deployment, either by:

    - co-investing directly in a portfolio of SIBs alongside other Social Investors;
    - providing loans to service providers (for implementing the social intervention that ultimately will achieve the contracted social outcomes) or to social investors (for initial SIBs investment);
    - providing guarantees (protecting part of the initial capital invested in each SIB from non-payment events, i.e. should the contracted outcomes not be achieved/validated).

Plotted against the standard SIBs diagram, the ESIF financing of the proposed systemic approach would look like this:



Social Impact Investment Fund in Andalucia and Valencia

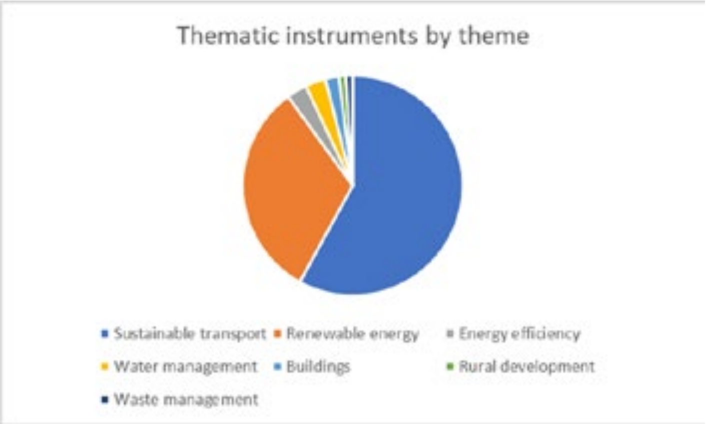
Market study

Size of the market

The situation of the market for impact investments in Spain is relatively initial if we compare it with other European Partners. There are estimations around a total impact investment of 300 million euros in 2017, with an annual growth rate 2015-2017 of +8% yearly. The long-term perspectives show that the Spanish Market for Impact Investing are about to create a momentum for growth.

Main recipients for impact investing in Spain are the green and social bonds, most of them related to the renewable energy projects and energy efficiency initiatives. According to available data, social investment funds and Impact Venture Capital are around 30% of total investment by asset class.

Consequently with this asset class classification, most of the funds are allocated in green investments related to renewable energy and sustainable development and energy saving projects, like sustainable transport or waste management.



According to these figures, social impact investments are only a small part of the total market size for impact investing, accounting for less than 100 million euros per year. This is a very small amount according to the Spanish economic size.

Summary for the demand side

1. Accelerators and incubators for impact entrepreneurship.

The presence of impact entrepreneurship in Spain is very weak, and it is mainly concentrated at territorial level. There are around 20 social impact accelerators and incubators in Spain. Most of them are located in the biggest cities of the country: Madrid and Barcelona. There are three impact investing incubators in Valencia and one in Andalucia, which has been recently created.

Due to the lack of infrastructure at territorial level, the report stated that there is the possibility of other incubators and accelerators -non specialised in impact investing- which might be supporting some projects that could be considered for impact investing. A further screening in non-specialized incubators and accelerators should be considered.

According to the sector, main reason for this lack of viable projects is related with lack of support at very early stages. Projects do not succeed in bridging the gap between the initial seed phase and the late stage phases. Main challenge in this area is to provide initial support for get the very early ventures to scale.

2. Social economy: cooperatives

Both Andalusia and Valencia have a long tradition on cooperatives and social business. Andalucía has a total amount of 5600 registered cooperatives and labour societies, while Valencia accounts for 3098 firms.

This social economy movement is well established, with strong firms, and it has its own network and associations, with specific initiatives to promote new social economy entrepreneurship projects. For instance, Faecta (Andalusia federation of workers cooperatives) has launched a social entrepreneurship incubator.
Despite this long tradition, social economy firms are not used to measure their social impact. They do not use standards or specific metrics, and this is a major challenge in order to access to the impact investing market. In this case, the "impact investing readiness" represents the main issue to tackle.

3. Other social economy networks

Aside the social economy, there is another potential demand player both in Andalucía and Valencia, which is the Alternative and social economy network. These entities are fair trade entities, project for social inclusion, consumer cooperatives, etc.

As in the case of the cooperatives, alternative and social economy is not used to work with standardised impact metrics. The main challenge for these entities is the "impact investing readiness" as well.

Summary for the supply side

1. Impact investing funds

There are so few specific social investment funds in Spain and most of them are located in Madrid and Barcelona. Main relevant social impact investing funds are the following:

- CREAS
- Inuit
- Ship 2b
- Bizakaia seed capital
- Investir
- Rezinkers
- Meridia Capital
- Gawa
- GSI

2. Social and ethical banking

There are two main social banks at national level: Triodos bank and Fiare. Other regional actors are the Caixa Popular -Valencia- and Cajamar -Andalucía and Valencia.

Main offered product are loans and microcredits under quasi-commercial terms, with collateral obligations. These funds are not appropriate for early stage and they do not consider the impact measurement systems from beneficiaries.

Key players from the intermediation side

In the intermediation sied, there is a well-established network of entities which support social entrepreneurs and impact investing:

- Ashoka Spain
- Impact Hub
- UpSocial
- El Hueco
- Ship2B

At the same time, and taking advantage of the ESF Spanish Operational Programme for Social Inclusion and Social Economy (POISES) there are two entities which support social entrepreneurship with Technical Assistance and training: Accion contra el Hambre Spain (action against hunger) and CEPES, the Spanish Confederation of Social Economy

Main conclusions from market study

Main conclusions from the market assessment are:

- Market is very small according to the size of Spain, compared with the European reference countries. This market is mainly dominated by social and green bonds and environmental themes.
- There is a growing network of accelerators and incubators, with some presence in Andalusia and Valencia, but there is a weak capacity to generate new social impact ventures. Assessment identified a bigger demand in cooperatives and “alternative” economy, while these entities are not ready to act as recipients for social impact investing due to the lack of capacities in the establishment of proper impact measurement systems..
- Regarding the supply side, there are few private VC operators with high level of concentration in Catalunya and Madrid, with less presence in Valencia and Andalucia. There are also some experiences in ethical and social banking, but their products are not appropriate for the early state and they do not measure the social impact of beneficiaries.
- Spain has a relatively well-established network of supporting institutions, which is now growing. Spain is about to enter in the Global Steering Group for Impact Investing, and this is generating a sort of momentum which can boost industry in the coming years.

Financial instrument

Funding gap

In order to get Spain to reach the European average impact investment per capita, Spain must multiply its impact investing amount per x40. Excluding *best in class* countries, Spain must multiply its impact investing amount per x8. This represent a total amount of 1974 million euros.

According to the distribution of impact investing in 2017, the amount aimed for VC funds should be around 217 million euros. From them, Andalusia should mobilise around 28 million euros and Valencia should mobilise around 18 million euros.

Taking into account the actual market size, A total yearly funding gap of 23,5 million euros has been identified for Andalusia and 15,8 million euros for Valencia.

Total market gap is depending on the final policy target. Other policy targets can serve to estimate a different funding gaps. Assuming that public intervention is aimed to cover at least 30% of total market gap, the estimation of needed public support is: 8 million euros per year for Andalucía and 6 million euros per year for Valencia.

Market failures

According to the market assessment, most market failures have been identified in early stages:

- **Risk aversion**: investors do not invest in seed stages due to the lack of an appropriate risk assessment. Firms which do not bridge the very initial phases do not receive private funds.
- **Information Asymmetries**: lack of knowledge and a proper evaluation of projects does not allow private investors to reach most interesting projects.

As a result of this market failures, support must be concentrated in seed capital, very early stages, with longer maturities terms. The support must be a risk-bearing instrument, aimed to crowd-in private investors for impact investing both in Valencia and Andalucía. Additionaly, a specific support to Social business might be provided for growth stages, as an incentive to establish and maintain impact measurement systems in the social economy sector in both regions.

Financial instrument proposal

Accordingly with this market failures, the proposed financial instrument is an instrument with two windows:

- One Co-investments instrument for early stage and seed capital in close cooperation with local accelerators and VC Funds. The instrument will be based in asymmetric risk sharing (first loss) to mitigate the risk aversion of private investors. The aim is to support the generation of new social business in a very early stage and to attract private investors in early stages.
- One Hybrid finance instrument for established social firms, aimed to establish incentives to impact investing readiness in social established firms and to support growth and expansión

Seed and early stage instrument

The feasibility study proposes an co-investment instrument aimed to provide equity investments in operations in very early stage –incubation phase- with long maturity terms. Main features of this instrument are the following:

- As the main target is to mitigate financial risk for private investors, the instrument will provide funding with a first Loss tranche up to 25% of total investment.
- Investment range: 50,000-250,000 euros, with a maximum of 49% of total capital
- The holding period would be 5 or more years. The instrument will act as patient capital, supporting the maturity of the projects and allowing them to bridge from the seed phase to later stages phases.
- The development of the instrument would be in close cooperation with local accelerators and incubators, and it will be open to co-investment with crowdsourcing platforms, once a threshold has been reached (50,000 euros). The instrument will be also open to generate blending with Technical Assistance instruments for the projects.

Mezzanine instrument (hybrid finance) for growth and expansion

The feasibility study is also proposing an instrument based on mezzanine funding (quasi-equity and subordinated loans) to established social business in growth stages. Main features of this instrument are:

- Offered financial product will be quasy-equity up to 200,000 euros: with variable rate of return. From 200,000 to 500.000 euros, financial product will be subordinated loans.
- An Interest rate bonification would be applicable, depending on the impact provisions compliance. The recipient must establish an Impact measurement system.
- The holding period would be of more than 5 years.
- Funding will reach up to 75% of total investment project. Private co-funding for the 25% will be needed. The fund would be open to co-investment with social VC funds and responsible banking.

Implementation

In Andalucia, the study support IDEA will be the fund manager, under the Andalucía Fund for Economic development. In Valencia, proposed fund manager would be the Valencian Institute for Finances. Additionally, the report suggests to appoint financial intermediaries under an open and competitive call for proposals.

In order to a better alignment of aims, financial intermediaries must contribute with at least 1% of total managed funds.

The Financial Intermediary remuneration will be based in the following pillars:

- Management fee, according to the General Provisions regulation.
- Performance fee, according to the General Provisions regulation.
- “Impact Carry” if the social impact aims have been accomplished. This accomplishment must be verified by an independent evaluator.

The fund will allow to use ring fencing within the regional scope in order to attract intermediaries to Andalusia and Valencia.

State aid provisions

1 Seed and early stage equity instrument:

The instrument is not a market-based instruments, due to the asymmetric risk sharing. The study supports the use of the State Aid Provisions under the Regulation of Block Exemptions section 3: Support to SME Article 21: risk financing.

2 Hybrid finance for growth

The instrument is not a market-based instrument due to the bonification of interest rate. The study supports the use of De Minimis rule for quasi-equity as upper limit is 200,000 euros, and de Minimis rule for subordinated loans if the amount if higher than 200,000 euros. In that case, GGE must be calculated on a case by case basis.

Impact measurement

Impact measurement is the forefont of the instrument. While there are different metrics and methodologies, the Financial Instrument is open and flexible in order to let the final recipients and the financial intermediary to use the most appropriate one.

In any case, the Financial Intermediary should present its impact measurement system to be assessed under the call for proposals and appointment process.

During the negotiation of the financial agreement with the Financial Intermediary, the agreement must specify that an external independent verification process must be carried out in order to assess the social impact compliance.

Social Impact Investment Fund in Piemonte

Market study

Size of the market

The Italian impact investing market is at an early stage development and a lot of work is still to be done, in order to reach the most advanced markets. The process is undergoing, but some changes in the legal and institutional framework have created the conditions for the development of impact investing in the Italian context.

The introduction in 2012 of innovative start-ups and social-oriented innovative start-ups as a possible legal form for a company, bearing advantages such as fiscal incentives for investors and a waiver on capital losses in the first 3 years, created a growing and clearly identifiable group of possible target companies.
This trend was reinforced by the adoption by law of "benefit companies" in 2016, a concept that is strictly connected with the B-Corp certification.
The Italian reform of the non-profit sector in 2017, introduced important changes that made social enterprises appealing to investors seeking high social impact and controlled financial returns.

Given this context, a growing number of investors and fund managers started approaching impact investing in Italy. According to the Eurosif Study 2018, impact investing in Italy amounts to about € 52 billion in 2017 with a double digit growth (it was less than € 10 billion in 2015).
As to the social venture capital market, it is still very small, with a total deals value in 2016 of € 6 million. A recent research made by the Milan Politecnico university estimates that managed assets in this sector could reach 400 million within 3 years, with an average of € 20 million invested capital per year.

	SOCIAL	TRADITIONAL
Active operators	6	30
Number of deals	15	128
Deals value	6 mil/€	104 mil/€
Average ticket	0.4 mil/€	0.8 mil/€

Source: FSVGDA research and analysis based on AIFA italian PE&VC report 2016 and private sources

Summary for the demand side

According to the *Tiresia Social Impact Outlook 2018* we have in Italy 9.382 enterprises which can be strictly classified as 'social impact operators', including social cooperatives, social enterprises ex lege 155/2006 and benefit enterprises. As emerged from the *Outlook* the investment readiness of these enterprises is still quite limited, especially due to the following reasons: limited size, insufficient capitalization, lack of managerial expertise, low technological intensity.

Level of investment readiness	**n°**	**%**
Very high	98	1.04%
High	529	5.64%
Medium	1939	20.67%
Medium-low	4466	47.60%
Low	2350	25.05%

Source: Tiresia Social Impact Outlook 2018

The potential market is actually much wider as it also includes 'de facto social enterprises' which can be non profit organizations (excluding social cooperatives) or limited companies operating within the sectors mentioned by the Italian law 118/05. This category amounts to approximately 140.000 units.

Moving to the regional level, the analysis of the data shows there are about 40.000 organizations with a social purpose in Piedmont. Out of these, only 800 are social enterprises ex lege (the vast majority of them are cooperatives). Among the social enterprises de facto about 4.000 are for-profit companies that pursue social goals, which are by nature the most interesting for investment. Among these, 1.812 companies (46%) operate in the culture, sport and recreation sectors, around 1.000 (27%) in the healthcare sector, 703 (18%) in the education and research sector, and 337 (9%) in social assistance.
The rest is made up of associations, foundations, committees, religious bodies or subjects that cannot be invested, mainly operating in sport and recreation sector.

These figures are not that large, but sufficient to justify an experiment, especially in the perspective of a market growth. Piedmont, also thanks to some pioneering initiatives in the Turin metropolitan area and the quality of public policies in the elective sectors of social entrepreneurship, can be an interesting innovation laboratory for a specialized financial operator.

Summary for the supply side

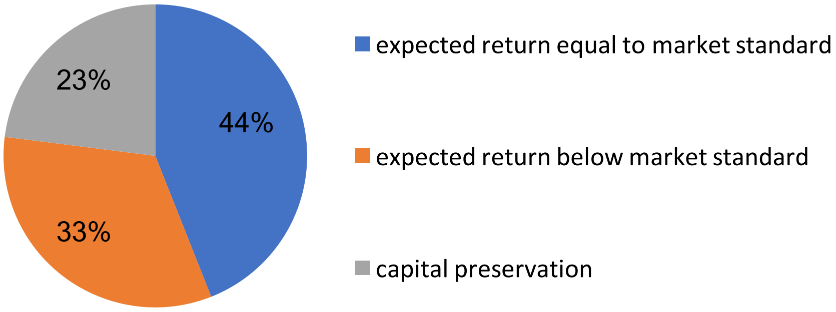
The supply of financial resources seems to be quite strong – as it ranges from €210 mil up to €6.5 bio – depending on how strict the definition is. In fact, the aforementioned *Tiresia Social Impact Outlook 2018* distinguishes three levels of supply of impact funds:

- Strictly impact, which amounts to about € 210 million
- Impact, which amounts to about € 1.5 billion
- Almost impact, which amounts to about € 6.5 billion

Impact investors do see the opportunity but see also may barriers such as:

- fragility of business models and poor deal flow
- unreliable impact measurement metrics
- small size of operations
- uncertain exit
- inadequacy of public support in terms of resources and policies

The expected return is, for more than 40% of impact investors, aligned with market standards.

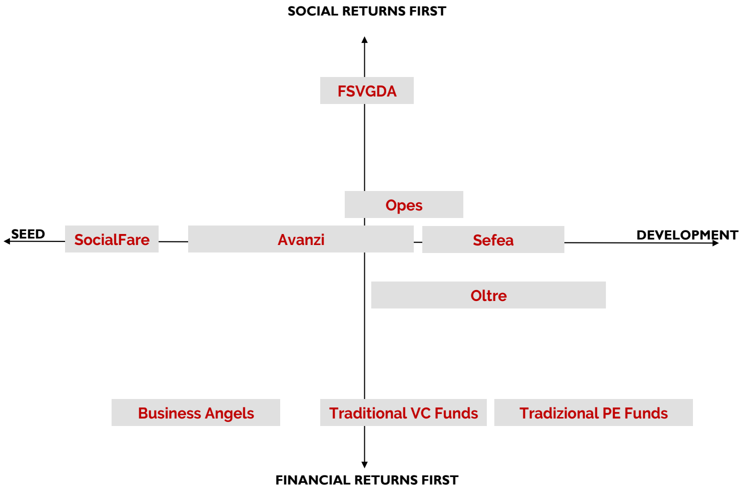


Source: Tiresia Social Impact Outlook 2018

Impact investors are relatively few and can be identified amongst:

- Public sector entities, both at national and European level: it is worth mentioning the Italian promotional bank (CDP), the National Investment Fund that will soon launch a special initiative for impact investing, and the European Investment Fund (EIF) with the Social Impact Accelerator facility.
- Foundations: Bank foundations are a peculiar case at international level (there are now 88 units in Italy, 2 of the most important are based in Piedmont). They can be considered as no profit, private and independent actors pursuing social goals, and having large available resources. Sectors where bank foundations are more active are: education, research, art, health and culture.
- 'Responsible' corporates
- Pension funds or insurances with SRI policies
- Banks, both ethic banks and commercial banks with special branches dedicated to impact investing; they offer traditional financial products and also innovative products specifically targeted to social impact, like social bonds.

The impact equity investment market is very small with few operators which are mapped in the matrix below.



Other key players of the ecosystem

In Italy, and in Piedmont in particular. There is a well-established network of entities which support and promote social entrepreneurs and impact investing:

- Human Foundation is a non-profit organization that promotes innovative solutions to growing social needs; it coordinates the Italian Advisory Board of the Social Impact Investment Taskforce established at the G8 and helped drafting the Italian Social Impact Agenda, a network that gathers together Italian impact investors.
- Italian Sustainable Investment Forum (ItaSIF) is a non-profit and multi-stakeholders organization, founded in 2001. Its mission is to promote at national level the integration of environmental, social and governance (ESG) criteria in the policies and processes adopted by the investors.
- Torino Social Impact is a platform that aggregates companies and public and private institutions aiming to implement a strategy for the development of high-tech social entrepreneurship in the Turin metropolitan area.

Main conclusions from market study

- Market is still quite small but it has been growing very fast in the last few years and it seems there is a great potential for further growth, mainly related to favourable institutional and legislative changes;
- The vast majority of social impact enterprises (*lato sensu*) is far from the investment readiness stage, due to economic, structural, legal, cultural reasons. They are on average very small and undercapitalised and they often lack of managerial skills, are very labour intensive (with low added value activities) and poor market orientation.
- Regarding the supply side, there are few private Venture Capital operators and most of them are still in a very initial stage of activity; there is an area of uncovered needs in the pre-seed and seed stage of enterprises, with high social returns but low financial returns.
- Italy, and Piedmont in particular, have a well established network of supporting institutions and two of the most important bank foundations which supply a large amount of resources to social and cultural initiatives.

Financial instrument

Strategic goals

Finpiemonte, as public financial agency of the Piedmont region, intends to intervene in areas of market failure uncovered by other financial operators. This means looking at companies at the very beginning of their development path which, while producing a significant social impact, may not be attractive to traditional capital providers due to their own economic-financial risk/return profile. In this framework, Finpiemonte intends to cooperate with other social investors which will be able provide additional financial resources, as well as non-financial services.

Furthermore, the action of Finpiemonte for the implementation of the financial instrument has a more systemic objective, namely to experiment an innovative model that can be transferred as example to other players, as to overcome the barriers that today hinder the matching between demand and offer of capital.

Investment strategy

Finpiemonte's Social Impact Fund (SIF) is designed to assists social businesses in the pre-seed and seed stages and to integrate the Piedmont ecosystem of investment, business acceleration, and business generation.

The SIF is expected to invest in companies established at least 3 months before the investment decision, which have already developed a proof of concept and can rely on an identified customer base. Spin offs of already existing companies or promoted by already consolidated operators can also be considered. Part of the resources will be used to support the expansion phase, both to increase the financial sustainability of the fund itself and to promote the growth of the investees.

It is planned to invests at least 70% of its assets in social enterprises (limited liability companies and joint stock companies) and social cooperatives defined according to the criteria of law 155/06. The remaining 30% should be invested in companies that, although not social enterprises by law, declare a clear social purpose and generate a measurable social value.

It will aim to work in synergy with other early stage investors and to coordinate with other players of the Piedmont ecosystem of social innovation - in particular, with accelerators and business incubators.

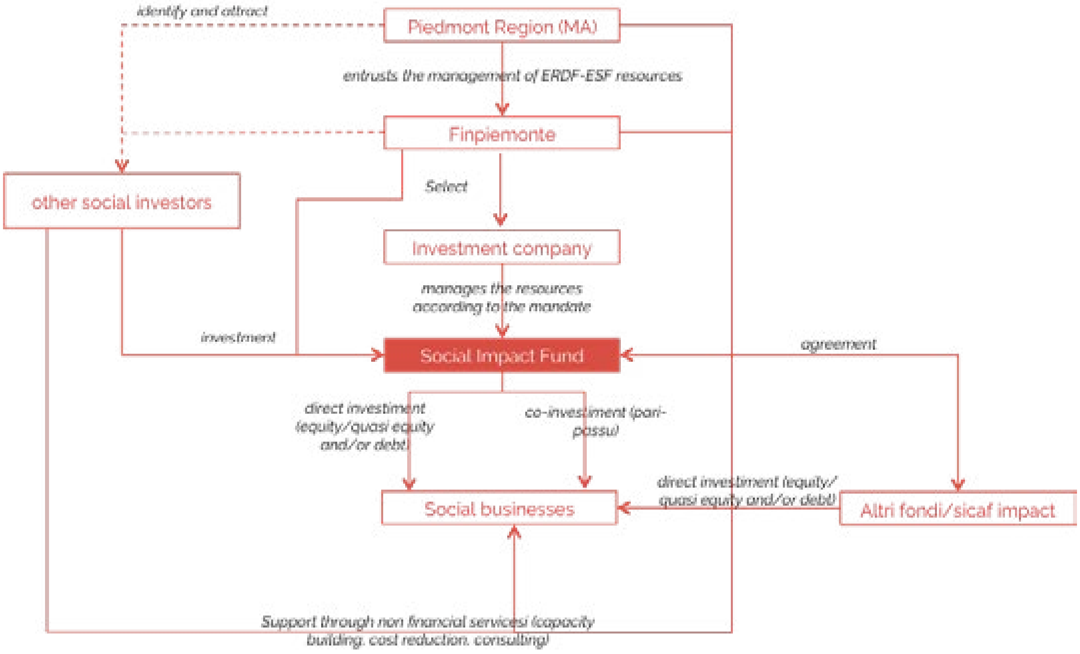
The SIF is planned to have a duration of 10 years (possibly extended to complete the divestment phase), with a maximum holding period of 5 years. It targets an internal rate of return of 2% net of management fees and net of exploration costs. The hurdle rate is set at 2%.

Finpiemonte envisages to mobilize resources of around € 5 million of ERDF funds, with the expectation to match them with at least € 10-15 million from other private investors. In a subsequent phase, Finpiemonte could envisage to mobilize additional resources from the European structural and investment funds.

Structure and governance model

The choice on the model has been taken considering a number of constraints, namely: (i) the impossibility for Finpiemonte to directly manage the financial vehicle, (ii) the complexity of the selection process of a supplier for indirect management, (iii) the small size of the fund and (iv) the legal boundaries set by the Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Structural Funds.

After all the technical investigations and political-institutional feasibility checks, the model that balance all internal and external conditions looks as follows.



This solution provides an indirect management model, via a mandate to a professional investment manager which will either invest directly or through other affiliated managers/vehicles.

The capital injection by Finpiemonte is supposed to have a catalytic role to leverage further contributions from social-oriented investors in the Piedmont area, with which Finpiemonte will establish a partnership agreement before the selection of the fund manager. Furthermore the fund manager itself could raise additional resources from the market.

This aspects will be discussed and examined in the public selection process of the fund manager, which will be structured as a competitive dialogue. Such procurement procedure will allow Finpiemonte to discuss with operators both on technical aspects related to the investment selection, and on impact evaluation process and financial aspects related, for example, to the choice between down-side protection scheme and up-side leverage scheme.

State aid provision

The instrument will be developed according to the State Aid Provisions under the Regulation of Block Exemptions section 3: Support to SME Article 21: risk financing. The fund manager will be selected by giving preference to downside protection over asymmetric profit-sharing, in order to limit a bias towards excessive risk-taking by the manager selecting the undertakings in which the investment will be done, as well as to ensure the revolving nature of the public capital committed and the long-term financial sustainability of the measure.

Implementation process

Preparatory activities

- Identification of other social investors willing to co-invest in the SIF and of other players of the social economy to enhance coordination of policies and actions;
- Design of an offer of non-financial services to support the solid growth of investees (capacity building, product/service design, organization, management, IT, marketing & sales, internationalization, fundraising …)
- Definition of the social impact assessment model
- Pre-development of the pipeline
- Definition of the investment mandate and the social incentive scheme
- Check on State Aid and Structural Funds regulations
- Selection of the asset manager through a competitive dialogue procedure

Launch and operation

- Activation of a committee to monitor the investment activity of the SIF manager
- Deployment of non financial supporting services
- Company-specific and aggregated impact assessment

Economics

Two different models have been elaborated and assessed with regard to their financial sustainability:

- € 20 million minimum for a fund that invests mostly indirectly (in other funds); direct investments are made on a *pari passu* basis with other investors
- € 30 million minimum for a fund that invests mostly directly and not necessarily with other investors.

Investment sizes

- € 150.000 for pre-seed
- € 300.000 for seed
- € 500.000 for expansion

Expected number of deals

	n°	amount
Indirect investments	7	€ 10.500.000
Pari passu pre-seed	14	€ 2.100.000
Pari passu seed	8	€ 2.400.000
Pari passu expansion	8	€ 4.000.000

	n°	amount
Indirect investments	7	€ 10.500.000
Pre-seed	19	€ 2.850.000
Seed	18	€ 5.400.000
Expansion	17	€ 8.500.000

Conclusions

- The social economy in Piedmont is experiencing a transformation process that might lead to a major change. Social businesses need to evolve in terms of entrepreneurial spirit, size, quality of product/service and market orientation.

- This transition phase will require investments, that will neither come from the public sector alone nor from the traditional financial system; hence, a specialised patient capital provider might find its space and play a crucial role.

- The main strengths of Finpiemonte's SIF are:

    - specialization, proximity and strong rooting in the regional ecosystem
    - flexibility in terms of multiple forms of support (equity, quasi-equity, debt)
    - positioning (bridge between public and private sectors)
    - synergy with other players of the ecosystem able to move additional resources
    - impact oriented approach

- The main weaknesses of Finpiemonte's SIF are:

    - economic sustainability, mainly due to the small size
    - uncertainty of the demand side
    - complexity and high transaction costs
    - uncertainty in exit strategy