Better Entrepreneurship Online Tool

Guidance Note: Access to Finance

Introduction

Access to finance has been identified as a key policy lever in building an ecosystem for social enterprises in Europe by entities such as the European Economic and Social Committee, the OECD, and the European Commission's Expert Group on Social Entrepreneurship (GECES) in their respective policy recommendations. This guidance note considers the issue of financing social enterprises rather than buying services from social enterprises, which is covered in the action area on access to markets.

Social enterprises are entities that seek a primary social mission, while operating in the market economy. In this process, they seek financing from diverse sources, including public funds, philanthropic foundations, impact investing, as well as mainstream financial institutions. However, social enterprises often face barriers in this process as they do not fit in many predefined funding criteria and there is a lack of understanding and knowledge of the risks and returns associated with investing in them from the perspective of potential finance providers. Due to the subsequent difficulty of accessing finance, social enterprises often need to work on building their capacity to be more financially self-sustainable and less dependent on external funding. However, some social enterprises do not know how to develop appropriate business skills and they struggle with access to funding of their core costs. Furthermore, the lack of access to finance and the reliance on so-called "boot-strapping" techniques, imply that some social enterprises find it difficult to scale-up. Lastly, it has to be noted that few external funders are prepared to bet on them. In this document, the topic of access to finance is contemplated from the perspective of the *demand* and *supply* sides.

For the **demand side**, it is clear that social enterprises need to develop their capacity to better communicate with potential funders and finance providers and become increasingly investable. Financing needs vary according to the stage of development of each social enterprise and opportunities to meet their needs differ among countries. With this in mind, it is important to take into account the role of the public sector in terms of: (i) developing its own services – *directly addressing social needs*, (ii) *purchasing services* from social sector entities, and (iii) as an investor in social innovation by *financing social enterprises* that experiment with new solutions that can later be replicated at national level. Social enterprises continue to play an important role as suppliers of services or goods to the public sector or as recipients of subsidies when they employ people from disadvantaged populations. However, the role of social enterprises as "investees" is a relatively more recent phenomenon. As investees, social enterprises are expected to produce a social return on investment, and often also a financial return.

For the **supply side**, private funding is not available in sufficient supply due to a lack of visibility and understanding of social enterprises within the mainstream financial community and the narrow- minded risk-return attitude of investors. This issue is compounded further by persistent regulatory hurdles and a lack of incentives associated with investing in social enterprises. Finally, due to their size, the financing amounts that most social enterprises need are relatively small, which means that financial intermediaries incur high transaction costs compared to the size of funding provided and the projected financial return. In addition, exit scenarios are often missing, as it is difficult for social enterprises to return investments at the level of at least capital repayment.

In a nutshell, the demand side needs to be supported in order to create more investable social enterprises, while the supply side needs to educate further the investors, provide support for the development of intermediaries, develop incentives and better regulation for investors and design co-funding schemes with public sources.

Recommendations for policy actions

Policy Levers

- ✓ Help to build the ecosystem by supporting the creation and development of intermediaries that strengthen the capacity of and finance social enterprises.
- ✓ Encourage the participation of mainstream and social investment by alleviating regulatory barriers to investment and by providing incentives to finance social enterprises.
- ✓ Leverage scarce public funding by using it to de-risk private funding and develop hybrid mechanisms that blend public and private investment.

Pitfalls to Avoid

- ☒ Avoid focusing on the availability of funding (supply) without the capacity of social enterprises to take in investment (demand). Actions need to contemplate both sides otherwise they may be counter-productive.
- ☒ In less mature markets, avoid replicating the latest innovations in more mature markets without having a similar ecosystem in place. Rather consider the various components needed to build up the capacity of all actors.

Guidance per assessment statement

4.1. The financing market has been mapped.

We invite you to examine whether the financial market has been mapped in your territory in order to inform policy actions. Who are the main actors that provide finance to social enterprises? Are there any intermediaries that help to match the needs of social enterprises with the available financial resources?

Why is it important?

The financing needs of social enterprises are different depending on their organisational structure and their stage of development. The maturity of the market, the availability of specialised funders in the territory, and the willingness of mainstream funders to support social enterprises can play a significant role in satisfying these needs. The first step for the development of tailored policy actions would be to identify the financing landscape at national, regional and local levels. Such a mapping exercise is necessary to make sure that the policies are appropriate and make sense for the specific context. A mapping exercise could include identifying the funding needs of social enterprises, and identifying and assessing the activities of the main actors and intermediaries and investors providing financing. The end result would be to have a clear idea of the market gaps and the most pressing needs that call for policy action.

Pointers to help tick the appropriate score

In order to score high, in your territory:

- An assessment has been undertaken in order to understand the financing needs of social enterprises.
- The main actors providing funds to social enterprises have been identified.
- The main types of financial intermediaries have been identified

4.2. Social enterprises have access to the appropriate type of financing for their stage of development.

We invite you to consider whether the available financial resources in your territory correspond to the diversity of the organisational structures of social enterprises and their stage of development. Is there a wide array of financial resources that can meet the needs of social enterprises? Are there hybrid instruments that combine different features of financial instruments available to social enteprises?

Why is it important?

Social enterprises may take on different organisational structures, ranging from for-profit limited companies, to cooperatives, and non-profit structures (associations, foundations, mutual, charities, trusts, etc.). Depending on the organisational structure, they can take on different types of financing. For instance, a non-profit organisation cannot take on equity whereas a community-interest company can but within certain limits. Social enterprises also have different needs depending on their stage of development. For example, at the start-up stage, it is more difficult to take on debt as it can take some time before the social enterprise is ready to pay back any principal and interest payments. Therefore, social enterprises need access to different types of financing instruments, which are available to cater to their needs emerging from their organisational structure and sizes. Hybrid forms exist in order to combine the attractive features of each instrument and help create an attractive financing package both for social enterprises and investors.

Pointers to help tick the appropriate score

In order to score high, in your territory:

- Grants and other subsidies are available. *(cloud: at the early stages and for the types of social enterprises that will never be completely self-sustainable)*
- Debt financing is available *(cloud: for social enterprises that have a revenue-generating model and can eventually return the debt and interest)*
- Quasi-equity or mezzanine finance is available. (*cloud: a high-risk loan, repayment of which depends on the financial success of the social enterprise, for example through royalties based on the future sales of a product or service)*
- Equity financing is available. *(cloud: for for-profit structures and in more mature markets where exits are feasible)*
- Innovative hybrid financing instruments that combine grants, debt, quasi-equity and equity are available.

Good practice example

Financing Agency for Social Entrepreneurship (FASE): An intermediary for hybrid financing (Germany)

Financing Agency for Social Entrepreneurship (FASE) is a financial intermediary providing hybrid financing to social enterprises. It uses a highly tailored, "deal-by-deal" approach in order to design innovative financing schemes that match the needs of social enterprises and impact investors. FASE has developed several innovative collaborative financing models, which can be assigned to three basic categories: 1) tailored financing; 2) hybrid co-operation; and 3) innovative financing.

Tailored financing

FASE has developed two tailored financing models: **the mezzanine capital with revenue participation and social impact incentive and mezzanine capital with profit participation and social impact incentive.** These financing models are specifically designed for hybrid social enterprises with both non-profit and for-profit subsidiaries. In general, while non-profit legal entities are able to accept donations or public grants, the most appropriate financing instrument for-profit subsidiaries is typically quasi-equity (e.g. mezzanine capital). Both models feature a social impact incentive in the form of a one-time final payment dependent on the enterprise's impact.

Hybrid co-operation

This second group features two solutions combining different types of investors in a single deal. The first one is **equity donation with impact investment** that combines philanthropic funders with investors. The second one is **crowd investment with impact investment** that splits the financing of the hybrid social enterprise between a crowd investment and an impact investment. The crowdfunding is very beneficial as it is highly flexible: the crowd can either finance the non-profit entity through donations, or support the for-profit organisation with investments.

Innovative financing

Two additional co-operation mechanisms address gaps in the social finance ecosystem, but require a separate financing vehicle. **The early-stage co-investment fund** is the most advanced such vehicle and tries to secure more financing for early-stage social enterprises – by offering impact investors access to a diversified portfolio of early-stage deals.

For more information, please [click here]

4.3. Social enterprises are supported by a number of specialised service providers.

We invite you to consider whether there are specialised service providers in your territory that help social enterprises to enhance their skills to find, attract and communicate with funders. If there are, are the services provided affordable for social enterprises? Is there any financial support that can help social enterprises access these services?

Why is it important?

Social enterprises often lack the capacity or knowledge to find, attract and communicate with funders. Capacity building needs are closely linked to funding. At the pre-start-up and start-up stage, the management team of a social enterprise may lack certain skills and experience, including those associated with accessing and utilising specific types of funding, or skills to render a social enterprise financially self-sustainable. At an early-growth stage, social enterprises need assistance to professionalise processes and functions. At a later growth stage, social enterprises would benefit from investment readiness programmes and support to create investable business models in order to scale their impact. Specialised service providers and intermediaries can be instrumental in this endeavour by matching the needs of social enterprises with specific programmes skills development and available funds.

In less mature markets, policy makers can support the emergence of specialised service provides that cater to the needs of social enterprises. In more mature markets, investment-readiness programmes can be set up to help social enterprises become investment-ready. Public agencies can contribute to the development of this aspect of the ecosystem. For instance, they could identify and provide a list of pre-approved specialised service providers that social enterprises can call on to gain access to high-quality and appropriate capacity building support. Of course, often the services provided by specialised providers are expensive, therefore, it is also useful if there is a dedicated financing vehicle that allows social enterprises to access these services at a subsidised or without cost.

Pointers to help tick the appropriate score

In order to score high, the ecosystem should include:

- Specialised services providers help social enterprises to develop the capacity to find, attract, and communicate with funders.
- These services are affordable.
- If these services are expensive, financing support is available to social enterprises for accessing them.

Good practice example

Portugal Inovação Social (Portugal)

Portugal Inovação Social acts as a market catalyst promoting the social-investment sector in Portugal and supports the emergence of specialised services providers. Through its capacity-building programme, Portugal Inovação Social aims to ensure that social enterprises can access the support services necessary to prepare themselves for investment, and thus grow and expand their valuable work most effectively. As a catalyst entity, it is using this programme to level the playing field among social and commercial enterprises by removing the barriers encountered by social enterprises in accessing specialist services. Through a voucher system, Portugal Inovação Social provides grants (up to a maximum of EUR 50 000) to social enterprises, enabling them to access support from specialist providers in areas such as financial management, business modelling, impact measurement, leadership and governance. This programme has available funding of EUR 15 million, and is expected to reach between 250 and 500 social enterprises by 2020.

For more information, please click here

4.4. Sufficient number of specialised private funders actively target social enterprises as an investment opportunity.

We invite you to examine the extent to which there are specialised private funders for social enterprises in your territory. Do these providers treat social enterprises as investment opportunities? Does this reflect the level of maturity of your ecosystem? Are there any policy actions, such as provision of funds, which contribute to the development and growth of these specialised private funders?

Why is it important?

Specialised private funders can act as catalysts for boosting the social enterprise financing market of a territory through various ways. For instance, they can introduce innovative financing instruments that combine grants, debt and equity. They could also mobilise resources and de-risk mainstream financing in order to make them accessible to social enterprises. In addition, specialised private funders can increase the attractiveness of social enterprise financing by highlighting emerging success stories and by convening key stakeholders in event to support social enterprises. Yet, specialised private funders (venture philanthropy, impact investment, ethical investment, social crowdfunding platforms, etc.) that actively target social enterprises as an investment opportunity are still limited in number, especially in less mature markets, and are themselves struggling in a resource-scarce environment. Therefore, policy makers can leverage public funds to support the development and growth of such specialised private funders.

Pointers to help tick the appropriate score

In order to score high, in your territory:

- Specialised private funders are actively targeting social enterprises as an investment opportunity.
- Public funding is used to incentivise specialised funders to actively finance social enterprises.

Good practice example

European Investment Fund's Social Impact Accelerator- an EU-level fund of fund investing in specialised private funders (Multiple countries)

European Investment Fund's (EIF) Social Impact Accelerator (SIA) is the first pan-European public-private partnership addressing the growing need for availability of equity finance to support social enterprises. SIA is a first step in the EIB Group's (European Investment Bank and EIF) strategy to pioneer the impact investing space and respond to the wider EU policy aim of establishing a sustainable funding market for social entrepreneurship in Europe. This segment of the business world is becoming increasingly instrumental in promoting social inclusion, providing alternative sources of employment for marginalised social groups, and contributing to growth. These goals underline the importance of SIA's aim to build up the existing market infrastructure for social impact investing in such a way that this emerging asset class is placed on a path to long-term sustainability. SIA reached its final closing in July 2015 at the size of EUR 243M, combining resources from the EIB Group and external investors, including Credit Cooperatif, Deutsche Bank as well as the Finnish group SITRA and the Bulgarian Development Bank (BDB). SIA operates as a fund-of-funds managed by EIF and invests in social impact funds which strategically target social enterprises across Europe. In the context of the SIA, a social enterprise shall be a self-sustainable SME whose business model serves to achieve a social impact by providing an entrepreneurial solution to a societal issue based on a scalable approach, and shall have a measurable impact.

4.5. Policymakers actively reach out to the mainstream funders to raise awareness about social enterprises.

We invite you to consider the degree to which public support is provided in order to raise awareness about social enterprises among mainstream funders. Often mainstream funders have limited understanding about social enterprises and their potential as investment opportunities or they lack the skills to undertake this type of investments. Are there initiatives in your territory that help mainstream funders better understand and learn how to fund social enterprises?

Why is it important?

Mainstream funders lack awareness about social enterprises as an investment opportunity, often due to the hybrid nature of the social enterprise (double or sometimes triple bottom line). Incentives and perceived risk of investment in social enterprises are often misaligned, implying that mainstream private investors are expected to take on a high degree of risk, with limited financial upside. To enhance the suitability of investment in social enterprises, policymakers at national level can work with their financial services regulators and professional bodies to introduce new- or develop existing- competency frameworks for advisers and fund managers to cover social and socially-oriented investments. In addition, policy makers can support the promotion and raising awareness efforts regarding the various ways to finance social enterprises among mainstream funders. For instance, they could present examples of credit provision conditions, such as longer repayment periods or no collateral requirements, to social enterprises by cooperative or community banks. Lastly, within the EU it would useful for mainstream private funders to have access to guidance material and/or capacity building meetings for navigating EU instruments supporting social enterprises.

Pointers to help tick the appropriate score

In order to score high, in your territory:

- Good practices of social enterprise financing are collected from the mainstream funding community.
- Awards and other types of dissemination activities about good practices in social enterprise financing are conducted.

- ➢ Trainings and guidance are available to financial institutions to build capacity on how to finance social enterprises.
- ➢ Guidance to finance providers on how to access EU instruments supporting social enterprise is available.

4.6. Public funds are leveraged to fund both social enterprises directly and through specialised intermediaries.

We invite you to consider the extent to which public funds are used to support social enterprise development. Do social enterprises receive public financial support? To what degree public funds are channelled for the creation of intermediaries or financial actors, such as seed funds or social impact investment funds, which can respond to the needs of social enterprises? Are guarantee schemes being used in your territory?

Why is it important?

Public funding in this context (to finance rather than to buy services from social enterprises – covered in the section on access to markets) is often difficult to channel directly to social enterprises because policy officers that administer public funds may not always perceive social enterprises as a funding option, or they may lack the skills, the capabilities and the networks to engage directly in social enterprise financing. Policymakers should consider how they can best support specialised intermediaries who have already developed the required expertise to finance social enterprises, through funds and guarantee schemes – de-risking private financing, through project grants and hybrid schemes supporting social enterprise development. Subsidies and public investment can also be used to encourage the creation of seed funds that focus on social enterprise development and of social impact investment funds with a patient capital approach. A variety of EU funds and programmes can be actively used in this context.

Pointers to help tick the appropriate score

In order to score high, in your territory:

- ➢ Social enterprises benefit from public grants supporting specific projects.
- ➢ Publicly supported financing schemes that combine grants, loans, guarantees and other financial instruments are used to build the ecosystem for the development of social enterprises.
- ➢ Financial intermediaries benefit from public guarantee schemes to provide funding to social enterprises.

Good practice example

The EaSI Guarantee Instrument (Multiple countries)

The EaSI Guarantee Instrument is funded from the European Commission's EaSI Programme and is specifically dedicated to microfinance and social entrepreneurship. One of its key objectives is to increase the availability of and access to finance for vulnerable groups wishing to launch their own enterprises, micro-enterprises and social enterprises, both in their start-up and development phases. EIF does not provide financing directly to micro-entrepreneurs or social enterprises. Through the EaSI Guarantee Instrument, the EIF offers guarantees and counter-guarantees to financial intermediaries, thereby providing them with a partial credit risk protection for newly originated loans to eligible beneficiaries. Intermediaries are selected after an application under a call for expression of interest followed by a due diligence process. Once selected by EIF, these partners act as EaSI financial intermediaries, and start originating loans to eligible beneficiaries within the agreed availability period. Thanks to the risk-sharing mechanism between the financial intermediaries and the European Commission, the EaSI Guarantee Instrument enables selected microcredit providers and social enterprise finance providers to expand their outreach to underserved micro and social enterprises, facilitating access to finance for target groups who have difficulties in accessing the conventional credit market.