Imperfections in the social investment market and options on how to address them

by

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On behalf of the European Commission

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1 Introduction

1.1 Scope

Social entrepreneurship is a field of rather diverse views. Globally, there are four different schools of thoughts and in Europe alone, researchers have identified five different welfare systems that form the context for social enterprises. The same applies for the financing of social enterprises. While some state that there is plenty of capital which only needs to be mobilized, others claim that there is not enough capital.

This report will analyse the various perspectives in depth, show the imperfections in the social investment market and ultimately develop three delivery options for an EU-level financial instrument. This ex-ante evaluation was commissioned by the European Commission and written by the authors between March and October 2013.

1.2 Definition

The underlying definition for a social enterprise is given in the following box.

Box 1: Definition of social enterprise

(a) „Social enterprise“ means an undertaking, regardless of its legal form, and which:

- (i) in accordance with its Articles of Association, Statutes or any other statutory document establishing the business, has as its primary objective the achievement of measurable, positive social impacts rather than generating profit for its owners, members and shareholders, where the undertaking
  - provides services or goods which generate a social return and/or
  - employs a method of production of goods or services that embodies its social objective;
- (ii) uses its profits first and foremost to achieve its primary objective and has in place predefined procedures and rules for any circumstances in which profits are distributed to shareholders and owners, in order to ensure that any distribution of profits does not undermine the primary objective;
- (iii) is managed in an entrepreneurial, accountable and transparent way, in particular by involving workers, customers and/or stakeholders affected by its business activities.

Extract from EaSI Regulation

1.3 European landscape

Most of the analysis of social enterprises and their financing structures is based on a single-country-perspective or the comparison of a number of selected countries (e.g. Scheuerle, Schmitz, Spiess-Knafl, Schües & Richter, 2013; Selusi Research Consortium, 2011). In a general overview, Kerlin (2010) identifies seven different regions worldwide and differentiates between Western Europe and East-Central Europe for European countries. A look at the classifications of the European welfare systems could potentially provide further insights toward the grouping of social entrepreneurship in Europe (e.g. Esping-Anderson, 1990; Salamon, Sokolowski & Anheier, 2000).

Research on the non-profit sector is often based on the liberal model. In this framework there is an ideological and political hostility towards any increase in the level of government outlay for welfare spending. Instead there is a preference for privately organized approaches in the provision of social services. The United Kingdom especially is often referred to as a liberal welfare state with a relatively large voluntary sector responsible for mobilizing private resources. By contrast, in what Salamon et al. (2000) call the social democratic model, state-delivered social services are prevalent and little room is left for non-profit organizations. Countries with a social democratic regime are the Scandinavian countries.

The combination of high levels of government spending with a large scale non-profit sector is the corporatist model. In this model, the state is cooperating with non-profit organizations. In a statist model the state controls a wide range of social policies and exercises significant power (Salamon et al., 2000). Those countries combining both aspects are often referred to as corporatist-statist countries and are, for example, Austria, France, Germany, Belgium, the Netherlands, Luxembourg and Ireland. These countries have a tradition which is shaped by the church and non-profit organizations which are mainly financed and regulated by public bodies and are important actors in the provision of social services.

The Mediterranean countries, which include Italy, Portugal, Spain and Greece are often referred to as corporatist states as well. However, welfare spending is generally lower and families factor as key actors in the welfare provision. Church-related charitable organizations may have played a central part but their role has been reduced in the last century. There is little research on Eastern European countries rooted in a post-communist tradition.

The mapping of social investment markets in Europe conducted by GHK (in press) shows a similar pattern. The United Kingdom has the most advanced social investment market in the European Union. From their findings it also seems that the Eastern European countries have the least developed social investment market with only a handful of social enterprise players active. The remaining picture is less clear and national social investment markets are in different stages of their development. Although discernible differences can be established regarding many areas of the European social investment market, the overall picture shows a growing and developing social investment market.

Country	Social banks	Impact Funds /VPOs	Other types of SIFIs	Main Foundations providing funding to SEs [1]	Commercial banks with specific product lines for SEs	Networks, Platforms, Exchanges	Specialised Financial Instruments	Role of Government	Key trends/ recent developments
Austria	HERMES-Österreich – *provides collateral to help social enterprises access to funding from commercial banks*	The German fund BonVenture is active in the Austrian market No of VP funds = 3	One online platform identified: http://www.respekt.net/ No of known MFIs= 1	Two main foundations: Erste Foundation ESSL Foundation	good.bee Holding GesmbH *– set up in 2008 by Erste Group (60%) and ERSTE Foundation (40%)*	-	-	Limited – estimated 10% of social entrepreneurs' budgets comes from federal resources	Increasing number of VPOs and foundations providing seed and venture capital to social entrepreneurs
Belgium	Crédal SC SCRL-FS Hefboom Triodos bank - Belgian branch	Impact funds: SI² Fund KOIS Invest No of VP funds = 1	No of known MFIs= 6	King Baudouin Foundation	-	-	-	Identified 5 Government backed funds	
Bulgaria	-	-	No of known MFIs= 33	-	-	-	-	Mainly EU funding	
Cyprus	Potentially- the Co-operative Central Bank Ltd (CCB) for farmers	-	No of known MFIs= 1	-	-	-		-	
Croatia	-	-	NESsT Croatia No of known MFIs= 2	-	It is reported that Erste and Zagreb banks have some products for SEs	-	-	-	
Czech Republic	-	-	NESsT Czech Republic No of known MFIs= 2	Nadace České spořitelny	Česká spořitelna *– part of Erste Group*	-	-	SEs predominantly rely on government grant schemes	

[1] Statistics on foundations available from EFC: http://www.efc.be/programmes_services/resources/Pages/Foundations-in-Europe.aspx

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Denmark	Merkur Cooperative Bank	Den Sociale Kapitalfond No of VP funds = 2	-	A number of foundations that provide grants, including the Velux foundation	-	Impact Invest Scandinavia http://impactinvest.se	-		
Estonia	-	No of VP funds = 1	No of known MFIs=1	-	Potentially, Swedbank	-	-	Funding comes primarily from foundations and government	
Finland	-	-	No of known MFIs=1	-	-	-	-		
France	Banque Publique d'Investissement Plus 5 more	Impact funds Specialised asset managers e.g. Mirova No of VP funds = 19	Pension schemes[2] invest 5 to 10% of their funds in social enterprises or social fund No of known MFIs=9	Yes	-	-	-	Government social innovation fund (coming in 2014)	

[2] FCPES – Fonds Commun de Placement d'Entreprise Solidaire

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Germany	3 social banks identified: GLS; Bank fur Sozialwirtschaft; Freie Gemeinschaft-sbank BCL	Impact funds No of VP funds = 11 Main VP funds: BonVenture, Social Venture Fund, LGT Venture Philanthropy	KfW (*KfW Programme for financing of social enterprises)* Finanzierungs-agentur für Social Entre-preneurship which was recently created by Ashoka Germany. It is a specialized finance team that will launch a new financing agency for social entrepreneurship over the next two years No of known MFIs=70	A number of foundations and family offices are engaged in (venture) philanthropy / social investment e.g Bertelsmann Stiftung NB: a number of these invest in developing countries	-	A social stock exchange NExT SSE: http://www.nextsse.com	The Benckiser Foundation is currently developing Germany's first Social Impact Bond under the name "Juvat"	As a conservative welfare regime, state has traditionally played important role in provision and financing of social services	Forum Nachhaltige Geldanlagen (FNG) estimates market at EUR 84M, exclusively microfinance investments Impact in Motion estimates investments by German investors/inter-mediaries in German social enterprises to amount to EUR 24M
Greece	-	-	No of known MFIs=1	-	-	-	-	A strategy has recently been produced[3]	

[3] http://ec.europa.eu/internal_market/social_business/docs/news/130708_social-economy-strategy-greece_en.pdf

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Hungary	A community bank (MagNet Bank, considering itself as an 'ethical bank') has recently started its operations in Hungary, offering favourable conditions to SMEs, social enterprises and NPOs	No of VP funds = 1	NESsT Hungary No of known MFIs=31	-	Erste Bank and Unicredit occasionally offer grants as part of CSR activities	-	-	Grants are the main form of financing for social enterprises	
Ireland	-	Clann Credo Ulster Community Investment Trust Ireland (UCIT)	No of known MFIs=1	The Social Finance Foundation (SFF). The SFF acts as a wholesaler to a set of approved Social Lending Organisations (SLOs). There are currently 4 such approved SLOs	SFF was set up with a EUR 25 million 'donation' from Irish retail banks, under the auspices of the Irish Banking Federation (IBF). In 2009 a further EUR 72 million low-interest loan was secured from Irish retail banks	-	-	Government-has backed SFF – wholesale fund with seed capital from IBF	The social investment sector is relatively small, but growing. As at July 2013, Clann Credo and UCIT had around EUR 24 million of outstanding social investment in Ireland: EUR 20 million by Clann Credo, and EUR 4 million by UCIT.

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Italy	2 identified: Banca Etica and Banca Prossima	1 impact / VP fund identified: Oltre venture capital sociale No of VP funds = 7	Cooperative Credit Banks No of known MFIs=6	A number of foundations – 7 identified. A prominent one is UMAN Foundation	Commercial banks covered close to 47 per cent of the Italian market for bank investments in social cooperatives	-	Social bonds launched in 2012 by UBI Banca and the CGM consortium		Social enterprises mainly rely on own funding or access financing from banks on commercial terms
Latvia	-	-	No of known MFIs=2	The Soros Foundation Latvia is one of the main donors	Some commercial banks such as SEB and bank Citadele occasionally provide grants to support entrepreneurs as part of their CSR activities	-	-	Grants are the main funding source for social entrepreneurs	
Lithuania	-	-	No of known MFIs=3	-	-	-	-	'Social firms' rely heavily on direct public subsidies	
Luxem-bourg	Etika	No of VP funds = 2	-	-	-	European Impact Investing Luxembourg	-	-	
Malta	-	-	Maltese cooperatives - the Central Cooperative Fund	-	APS Bank	-	-	Government is the main source of funding for social enterprises	

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Nether-lands	Triodos ASN Bank	Several funds are active in the Netherlands No of VP funds = 7	Crowd funding: Crowdaboutnow Wekonemerwel Seeds No of known MFIs=7	A number of family/ philanthropic foundations e.g Stichting DOEN, Oranjefonds, VSBfonds, d.o.b foundation, Noaber foundation, Brenninkmeijer foundations	Most commercial banks have special subdivisions in the Netherlands for specialist charity and social enterprise departments. Such commercial banks include, for example, ABN Amro, SNS, Rabobank etc	-	Catalytic first loss capital (although developed in the context of the government of the Netherlands; program managed by FMO; geographical focus: Tanzania)	There are several Government backed grant schemes	

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Poland	-	2 funds: TISE fund owned by French social bank Crédit Coopératif. TISE, also manages the publicly funded 'ES Fundusz' In 2013 the pilot project of a Social Economy Fund (ES Fundusz) commenced. Financing is provided in the form of concessional loans with technical assistance of a large state-owned bank BGK and TISE	No of known MFIs= 5	Prominent ones include Foundation for Social and Economic Initiatives (FISE), Barka Foundation	-	-	-	EU funding still remains the major (often only available one) and largest source of financing for social enterprises/ social economy sector in Poland	Traditionally, about 20% of a Polish social enterprise's turnover is generated through 'trading', according to FISE
Portugal	In 2014 Santa Casa da Miser-icórdia de Lisboa aims to roll out the Social Innovation Bank	Law is being adapted to allow the creation of social investment funds	No of known MFIs= 2	Foundations are quite active	-	Social stock exchange: BVS Portugal opened in 2009	-	Public/ government funds are the main source of social finance	

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Romania	-	1 fund identified: TreeTops capital	NESsT Romania No of known MFIs= 14	Yes	-	-		EU funding plays an important role in supporting the establishment, development and operation of social enterprises	
Slovakia	-	-	NESsT Slovakia No of known MFIs= 1	ERSTE Foundation, Ashoka	Goodbee	-		As above	
Slovenia	-	Sklad 05 (Social Investment Fund 05) is the first social investment fund of its kind in Slovenia	No of known MFIs= 3	-	-	-		As above	
Spain	Triodos Fiare Civic Bank	No of VP funds = 9 Funds have been set up by Creas and Isis	No of known MFIs= 62 Impulsa coop: an investment society for social economy enterprises and cooperatives	Foundations are quite active. Key players: Creas Foundation, Isis Foundation	large corporations such as La Caixa, BBVA, and Caixa Catalunya have set up grant and social investment programs	Spainsif (Spanish Social Investment Forum)		A number of funds and initiatives backed by the Government	

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Sweden	Ekobanken	No of VP funds = 2 Reach for Change Inkludera Invest Impact investors: Hjärna Hjärta Cash Upstart Malmö Sätila Holding	IOGT-NTO, a Swedish temperance movement No of known MFIs= 5	Jochnick Foundation - *Big foundation, mainly investing internationally. Outsourced part of support to Ashoka Scandinavia*	-	Impact Invest Scandinavia Swedish platform for social innovation		Public authorities, most notably municipalities, still provide a large proportion of funding for SEs	
United Kingdom	4 social banks: Triodos Bank, Charity Bank, Ecology Building Society, and the Unity Trust Bank	No of VP funds = 40 A number of funds: Big Issue Invest; the Social Investment Business; CAF Venturesome; Bridges Ventures Impact Ventures UK LGT Venture Philanthropy; Resonance which manages 2 social impact funds	There are currently about 60 active CDFIs operating across the UK - of these 19 are engaged in social investmen Business angel co-investment fund for social enterprises	Philanthropy is a key source of finance for the social investment sector	Deutsche Bank Impact Investment Fund The Royal Bank of Scotland	Social stock exchange RBS social enterprise Index (SE100 index) Abundance – crowd funding platform for Renewable Energy Projects Ethex investment club, providing online detailed information on equity-focused investments in socially directed companies and co-operatives	Social impact bonds	Government is actively supporting the development of social investment market. It launched the Big Society Capital with capital of £600m with which to help build the sector. Plans to introduce tax incentives for certain types of social investments	Estimated 29 SIFIs (4 social banks + 19 CDFIs + 6 other SIFIs) and GBP 202 million in UK social investment market Plans to increase participation of institutional investors, particularly pension funds

Table 1: Social Investment Markets per Country

Table based on GHK (in press)

2 The financing of social enterprises

This second chapter will introduce the elements of the social capital market with all relevant financing instruments, revenue streams and actors involved in the social capital market.

2.1 Financing instruments

Social enterprises have access to a range of financing instruments. Grants and debt capital are common for non-profit organisations but also available for social enterprises. Equity capital, debt capital and mezzanine capital are common for for-profit companies but available for social enterprises as well. Moreover, hybrid capital combines grants with debt or equity capital.

In line with accounting theory, grants are defined as a financing instrument. Grants are usually provided for the financing of a predefined project and do not require repayment. Although, they are financially attractive the social enterprise may have high fundraising costs and a reduced entrepreneurial flexibility as a result. Foundations or donors may have certain preferences on how to use the funds (e.g. regional or programmatic preferences) also reducing entrepreneurial flexibility.

Debt capital is widely used among those non-profit organisations which have a stable business model (e.g. health care, elderly care, education) and need to finance a building or other equipment. Debt capital is also available for social enterprises but depends on the business model and the stability of the cash flows. Debt capital provides a high degree of entrepreneurial flexibility and does not entail a loss of ownership.

Equity capital is available to all social enterprises with a legal form which allows equity investment. A number of legal forms do not allow equity investments such as those with restrictions for the distribution of profits or voting rights (e.g. Linklaters, 2006; Pöllath, 2007). In practice, social enterprises use models which are often referred to as the “satellite model”, “stabilizing-wheel strategy” or “catamaran strategy”. In these models a non-profit organization owns a for-profit entity which serves as a vehicle for external investments and for-profit operations. One permutation might be for the for-profit entity to enter into partnership and pay a royalty fee to the non-profit entity for the use of its brand name.

Equity capital entails no mandatory repayment of the invested capital and annual payments depend on the profits of the company. This makes it financially more attractive than debt capital. However, an equity investment means a dilution of ownership and the loss of control and voting rights for investors. Moreover, an equity investment could have an impact on the corporate culture of the social enterprise. Governance structures are considered to be helpful in balancing the interests of the owners.

Mezzanine capital is a combination of debt and equity capital. It is repayable and has an equity component in the form of profit participation. Hybrid capital combines grants with equity or debt capital. Hybrid capital instrument include recoverable grants, convertible grants, forgivable loans or revenue-share agreements.

These financing instruments are shown in the following table.

Financing Instrument	Term Sheet		Implications for Social Enterprise
Grants	Duration: Annual payments: Repayment:	Short term None None	- Usually restricted use for predefined projects - High fundraising costs - Low entrepreneurial flexibility
Debt Capital	Duration: Annual payments: Repayment:	Long term Interest payments Yes	- Low risk business model required - No dilution of ownership - Loss of far-reaching rights in case of default - High entrepreneurial flexibility
Equity Capital	Duration: Annual payments: Repayment:	Unlimited Dividend payments No	- Dilution of ownership - Control and voting rights for investors - Profit participation for social investor - Potential impact on corporate culture
Mezzanine Capital	Duration: Annual payments: Repayment:	Long term Interest payments Yes	- Structure requires predictable cash flows - Dilution of ownership if converted into equity - Mandatory repayment - Profit participation for social investor
Hybrid Capital	Duration: Annual payments: Repayment:	Long term None Depends upon structure	- Inexpensive financing instrument - No dilution of ownership - Risk sharing with the social investor - Great structuring flexibility

Table 2: Financing Instruments

Source: Achleitner, Heinecke, Noble, Schöning & Spiess-Knafl (2011)

2.2 Revenue streams

While for-profit companies usually base their business model on revenues generated through sales, social enterprises have a range of revenue streams they can use.

Countries with developed welfare systems, which applies to all European Member States, often have quasi-markets for social services. Most often non-profit organizations but also social enterprises can build a business model around these quasi-markets. That means that there may be fixed fees or contracts for certain services which can be found in elderly care, educational services or social services in general. The structure of these payments can be quite different, varying from direct payment by public authorities, to voucher systems, or indirect payment through third-party intermediaries.

Although there are some views that these markets do not represent entrepreneurial behaviour and they are certainly different from earned income from private individuals, these markets still make up significant funding sources for social enterprises. Even in the UK half of all social enterprises are trading with the public sector (Social Enterprise UK, 2011).

Besides fixed fees and contracts, public authorities often provide subsidies. That means that social enterprises receive subsidies for projects the authorities consider worthwhile supporting. Those subsidies will be variously structured among the EU Member States but are not likely to be the main funding source, although they still constitute an important funding source for social enterprises.

Earned income is what most researchers and practitioners see as the most relevant revenue stream. These revenues are generated through the provision of services or the sale of products and are paid by the target group or third parties.

Box 2: Example of earned income generation

Dialogue Social Enterprise and its subsidiaries (hereinafter DSE) *seek to overcome barriers between "us" and "them" and to redefine "disability" as "ability," and "otherness" as "likeness" (Dialogue Social Enterprise, 2011)*. To reach this goal, DSE runs exhibitions in which blind guides lead visitors through a completely dark environment to experience the daily routine of blind persons. The visitors are led through a real-life environment which includes supermarkets, a city theme or a café. Based on this concept, the social enterprise has also developed "Dialogue in Silence" and workshops for corporate clients. Since the foundation, 7 million visitors have experienced the exhibition and 7,000 blind persons have gained access to the employment market through their work with DSE.

The social enterprise has two revenue streams. The concept is scaled globally using a franchise system which provides DSE with income to provide for planning and development support. Additionally, DSE operates permanent exhibitions in Frankfurt and Hamburg and conducts workshops with corporate clients on all continents generating revenues through visitors and workshop participants. The annual revenues amount to around €5 million without dependence on federal funding or donations and the stable business model makes DSE suitable for financing through Venture Philanthropy funds.

Extract from Achleitner & Spiess-Knafl (2012)

Membership fees are another way to finance the operations of a social enterprise. Members may be a politically relevant base for the enterprise's own agenda as is the case with ecological preservation initiatives or pressure groups. Memberships can also be a way to finance so-called club goods. Those club goods have a clearly definable target group and can usually be found in leisure activities, sports or cultural activities. In a German sample, 4.9%

of all social enterprises surveyed used membership fees as their main income stream (Spiess-Knafl, 2012).

Sponsoring can be an additional revenue stream where companies aiming to associate themselves with the positive image of a social enterprise pay a certain amount in the form of sponsoring. In the same German sample, 6.6% of the social enterprises used sponsoring as their main income stream.

Other forms of revenue include penalty payments, prize money or income from endowed assets. Moreover, there are non-monetary forms which can be classified as revenue streams since they have a monetary value such as in-kind donations (e.g. old IT equipment, food or building material) and even volunteering time. Revenue streams are listed below.

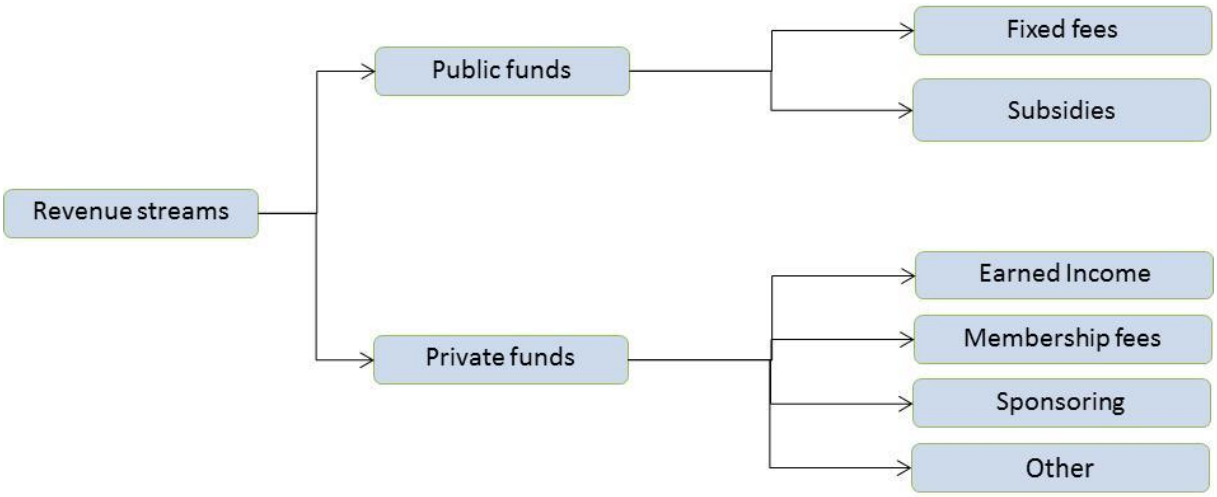

Figure 1: Revenue streams
Source: Spiess-Knafl (2012)

2.3 Social investment market

On the following pages the actors within the social investment market will be presented. Some of the actors are exclusively focused on the social investment market while others add these activities to their other already existing activities.

2.3.1 Venture philanthropy funds

The concept of venture philanthropy can be traced back to an article by Letts, Ryan & Grossman (1997), in which the authors asked what foundations could learn from venture capital funds. Venture philanthropy funds apply venture capital techniques to the financing of social enterprises. Those concepts include a high-engagement approach: a tailored financing strategy over a couple of years combined with non-financial support, organizational capacity-building and performance measurement (John, 2006). Heister (2010) also sees a multi-stage selection process as a characteristic of venture philanthropy funds.

Venture philanthropy funds use either a grant-based or a commercial strategy. This means that they either provide grants or equity or debt capital with a financial return requirement. According to a survey conducted by the European Venture Philanthropy Association (EVPA), European funds have already invested €1,044 million since the beginning of their operations (Hehenberger, 2012).

In a different study Weber & Scheck (2012) estimate the market volume for Germany to be €24 million, mainly based on the fund size of two German venture philanthropy funds. In the following table five European venture philanthropy funds from different countries will be portrayed focusing on their concept and investments.

Venture Philanthropy Funds	Description	Amount of capital	Selected Investments		
			Name of Investment	Short Description	Amount & Instrument
Germany	**BonVenture** funds companies and organizations with a social purpose in German-speaking countries. The fund seeks projects that are innovative with a strong social impact, are led by motivated and committed social entrepreneurs, and will be financially self-sustaining in the long term in the areas of social businesses, ecological impact and societal improvement.	€15.7 million	Ilses weite Welt	Holistic interactive concept for dealing with senile dementia in everyday life	Not publicly disclosed
			rock your life!	University students coaching problematic junior-high pupils	Not publicly disclosed
			Kinderzentren Kunterbunt	Responsible day care centers with proximity to the workplace	Not publicly disclosed
			Wald 21	Ecological responsible tree nurseries for high grade wood	Not publicly disclosed
			Parlamentwatch	Monitoring of the political activities of the representatives in the German Parliament	Not publicly disclosed
United Kingdom	**Bridges Ventures** is a sustainable growth investor whose commercial expertise is used to deliver both financial returns and social and environmental benefits. They believe that market forces and entrepreneurship can be harnessed to do well by doing good. They currently have three types of funds under management.	GBP 300,000,000 in 3 funds	Auto 22	Car service garage with preferable employment of young people, reinvesting in new job opportunities	Not publicly disclosed
			Care and Share associates	Employee-owned homecare franchises for elder people	GBP 200,000 Debt Capital
			cloud.IQ	Apps and technical backend provision for firms of all kind	GBP 2,000,000 Equity
			Hackney Community Transport HCT	Employment and social inclusion of the disadvantaged and community development	GBP 2,000,000 Debt Capital
			Historic Futures	Supply chain adjustment to assure it complies with corporate governance goals, reduces emissions and waste	GBP 1,600,000 Equity

Venture Philanthropy Funds	Description	Amount of capital	Selected Investments		
			Name of Investment	**Short Description**	**Amount & Instrument**
noaber foundation Netherlands	**The Noaber Foundation** aims to initiate and support the acceleration of innovations in the civil society where “noabership” (neighbourship) is key. These innovations are related to health and care, education and community building. To reach its aims, the foundation acts as an “entrepreneurial philanthropist”.	Not publicly disclosed	Abakus B.V.	Elaborated digital doctor-patient consulting system	Not publicly disclosed
			Autest	Employment of autists as software testers	Not publicly disclosed
			Carefarm ’t Paradijs	Agricultural farming project, which lets visitors participate in the farming business	Not publicly disclosed
			Loco Tender B.V.	Specialized schooling system for children with learning disabilities	Not publicly disclosed
			Mentalshare	Provision of e-mental health services for effective prevention and treatment of mental disorders	Not publicly disclosed
Oltre VENTURE CAPITAL SOCIALE Italy	**Oltre Venture** is the first Italian Social Venture Capital company, supporting the growth of enterprises which are able to match social value and economic sustainability. Such enterprises appeal to the grey area of invisible hardship and to fragile social-economic problems such as: housing discomfort, unemployment, solitude and marginalization.	€10 million	Ambulatorio Dentistico Boccaleone Sri	Offers access to high-end dental care to the economically weak	EUR 115,000 Equity
			Centro Medico Santagostino	High level of all kinds of specialized medicine, available to all	EUR 1,500,000 Equity
			Concordia Spa	Housing for elderly with special care facilities	EUR 300,000 Equity
			Fraterniti Sistema	Cooperative specializing in services for public administrations such as tax plannings and collection of those	EUR 300,000 Equity
			Personal Energy	Planning and installation of photovoltaic systems	EUR 570,000 Equity (100% stake)

Venture Philanthropy Funds	Description	Amount of capital	Selected Investments		
			Name of Investment	**Short Description**	**Amount & Instrument**
PhiTrust Partenaires France	**PhiTrust Partenaires** is dedicated to funding and mentoring companies in the fields of social business through its foundation and social investment funds. Phitrust focuses its investments both at a European and a worldwide level. PhiTrust Partenaires can be seen as the social division of the PhiTrust Asset Management Group	EUR 5,221,700 total Portfolio consisting of EUR 3,555,000 Equity and EUR 1,666,700 Debt and Loan capital	Association Chênelet	Cooperative, providing excluded people with an accomondation, job and healthcare paired with quality of living	EUR 50,000 Equity
			Dialogue social enterprise	Disabled people guide through exhibitions in which visitors explore the life of blind people	EUR 3,000 Equity, EUR 150,000 Debt Capital
			Ecodair	Refurbishment of computer technology by mentally impaired people	EUR 65,000 Equity, EUR 200,000 Debt Capital
			Ethical Property	Development and management of office space for non-profits in high-environmental quality (HEQ) buildings	EUR 530,000 Equity
			Foncière Chênelet	Social housing project with support from companies providing sustainable building materials	EUR 150,000 Equity, EUR 100,000 Debt Capital
			Groupe la Varappe	Social reintegration through employment in construction, waste treatment, maintenance of green spaces and installation of solar panels	EUR 400,000 Equity, EUR 52,000 Debt Capital

Table 3: Selection of European Venture Philanthropy Funds

Source: Own research, EVPA, Company information

2.3.2 Banks

In Europe, there are two kinds of banks which are active in the financing of social enterprises. Social-ethical banks such as GLS Bank or Triodos are part of the Global Alliance of Banking on Values (GABV). Loans are given to companies or organizations which fit into their respective mission statement. Their growth over the last years has been fuelled by the desire of individuals to support ethically-oriented banks. Their assets are shown in the table below.

Bank	Country	Assets (in billion Euros)[4]
Alternative Bank Switzerland	Switzerland	1.0
Banca Popolare Etica	Italy	1.0
Crédit Coopératif	France	14.9
Cultura Bank	Norway	0.1
Ecology Building Society	UK	0.1
GLS Bank	Germany	2.7
Merkur Cooperative Bank	Denmark	0.3
Triodos Bank	Netherlands	5.3
Total		25.4

Table 4: European members of the GABV
Source: Global Alliance of Banking on Values (2013)

There are also other banks which have a philanthropic agenda and are involved in the social capital market. Deutsche Bank, Berenberg and LGT launched impact investment funds, UBS offers clients philanthropic services, Erste Bank is starting to provide loans to social enterprises and Gruppo Intesa set up Banca Prossima dedicated to the financing of the non-profit–sector.

responsAbility was founded 2003 by Swiss financial institutions such as Credit Suisse, Swisse Reinsurance or Bank Vontobel and is an asset manager for social investment. Current assets under management amount to USD1.4 billion and investment products include microfinance, fair and small and medium-sized enterprises in developing countries and independent media.

2.3.3 Social investment banks and other financial intermediaries

Big Society Capital is the first Social Investment Bank which was founded in the United Kingdom and has a capitalization of 600 million pounds (Cohen, 2011). Besides Big Society

[4] In addition to assets on the balance sheet Crédit Coopératif and Triodos Bank had around €9 billion in funds under management.

Capital there are other social investment advisors such as Bamboo Finance or Social Finance which try to match supply and demand by offering structured investment products.

There is also a Social Stock Exchange being launched in London which aims to raise the visibility of businesses generating a social and environmental impact and to help channel investments in this area. Although the Social Stock Exchange does not offer a trading platform it still connects investors and business and develops an appropriate Impact Report.

2.3.4 Crowdfunding platforms

Crowdsourcing (2012) estimates that there are 452 crowdfunding platforms worldwide and that these platforms raised $1.5 billion for one million campaigns in 2011. In Europe alone, they estimate the number of campaigns to exceed 650,000.

Platforms can be classified according to the financial instrument used on the platform. These types are (1) equity-based, (2) lending-based, (3) reward-based or (4) donation-based. While two-thirds of the donation-based and rewards-based projects individually generate less than $5,000, 80% of the equity-based and lending-based crowdfunding projects raise above $25,000 each (Crowdsourcing, 2012). On the other hand, Marchant, Maurel, Moullet, Tondu & Faivre-Tavignot (2011) report that the lending-based projects for social business address only small-size projects up to €3.000.

There are a number of resolvable issues related to financing through crowdfunding-platforms. Confidentiality agreements are hard to realize in this context given the sheer amount of individual investors. Control and voting rights need to be pooled and the structured as the enterprise can hardly interact with every single shareholder. Moreover, the secondary market for shares of projects aiming for a financial return needs to be structured and coordinated (Kortleben & Vollmar, 2012)

2.3.5 Charitable foundations

Charitable foundations have a pool of endowed assets which they use to support a social purpose. In the normal case charitable foundations are investing their assets in the traditional equity and bond markets and use dividend and interest payments for their social mission. The following table gives an overview of the assets and number of charitable foundations in Europe.

Country	Number of foundations[5]	Assets[6] (€ billions)	Expenditures[7] (€ millions)
Finland	2,660	10-12	290
France	2,264	14.3	4,900
Germany	19,951	70	17,000
Italy	4,720	85	11,500
Netherlands	57,000	60	215
Slovakia	376	71	47
Spain	9,050	17	5,000
Switzerland	12,715	61	875-1,700
Turkey	1,500	34	3,200

Table 5: Selection of charitable foundations in European countries[8]

Source: European Foundation Centre (2013)

One of the main levers for the social investment market are assets of foundations which could be used for the financing of social enterprises. Although data remain scarce it can be assumed that charitable foundations have significant amounts of assets and there is considerable interest in providing those funds to the social investment market.

Evidence can be found in a German sample. Schneeweiß & Weber (2012) found that 58% of the surveyed charitable foundations are interested in so-called mission investing, which refers to the use of a foundation's assets for the social investment market.

2.3.6 Family offices

There is an increasing interest among high-net worth individuals to invest in social enterprises. Publications for high-net worth individuals are regularly published and events are geared to mobilize assets of family offices. Family offices are unregulated and thus relatively free to integrate social objectives into their investment strategy. The European Venture Capital Association (EVCA) estimates that there are around 500 family offices active in Europe, of which 80 to 100 have over €1 billion in assets under management (Leleux, Schwass & Diversé, 2007).

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[5] The definition for what is considered as a foundation differs between the countries. The number of foundations for each country covers only domestic foundations and include as much as possible "public-benefit foundations". Countries which are not included have no full information base or no consistent legal forms, such as Ireland where there is no legal form for foundations and the form foundations can take is not prescribed in law.

[6] Assets refer to the total assets owned by foundations in the country on a book value basis.

[7] Expenditure is the amount foundations spend on projects or programs for the public benefit.

[8] Selection only includes those countries with all numbers available.

3 Imperfections

Finance is a functional science in that it exists to support other goals (Shiller, 2012). Still, there are a few imperfections in the social investment markets which will be analyzed in this chapter. To better understand these imperfections the chapter first takes a look at the characteristics of the financing of social enterprises.

3.1 Aspects of social finance

3.1.1 Missing link between return and risk

One of the main pillars of finance theory is that there is a relationship between the expected rate of return and the risk of the investment. An investment with a higher risk must thus offer a higher expected rate of return. For the financing structure of social enterprises there is no similar relationship (Achleitner, Spiess-Knafl & Volk, in press).

Investors might be willing to reduce their financial return expectation as they wish to support the social services provided by the social enterprise. That means that they follow a multi-dimensional return requirement consisting of expected financial and social returns. Additionally, some investors might even provide interest-free or low interest loans as part of this investment strategy. The financial rate of return can therefore not be considered in an isolated way and must be considered jointly with the social return the social enterprise is offering.

3.1.2 Missing pecking order

The pecking order known from traditional finance theory predicts a preference order for new financing instruments, from the top where internal financing is the most preferred down to equity capital as the least preferred financing instrument (Myers, 1984; Myers & Majluf, 1984).

As shown in the previous chapter, social enterprises have a range of financing instruments they can access to fund their business. In terms of financial attractiveness grant funding is hard to match as grants are not repayable, have no regular payment obligations and do not entail control or voting rights. However, grant funding can be burdensome for the management and reduce the entrepreneurial flexibility due to reporting requirements and specified expectations of the grant provider. In terms of entrepreneurial flexibility debt or equity funding can be more attractive to social enterprises although the financial attractiveness is much lower. Therefore, traditional pecking order theory is not applicable (Spiess-Knafl, 2012). The decision for equity or debt capital will depend on the costs (e.g. interest rate or dividend expectation) of the available financing instrument as well as company-specific determinants. A non-profit legal status might restrict equity capital and lead to a preference for debt capital. Social enterprises with a lack of predictable cash flows might prefer equity capital to reduce a bankruptcy risk.

3.1.3 Divergent return expectations

The previous chapter has shown that investors have different return expectations in terms of financial and social returns. It may be possible that one investor has no financial return expectations while another investor expects to earn market-level returns.

There are three types of capital providers which can be defined according to their social and financial return requirements:

- Investors with market-rate financial return expectations (e.g. banks or investors focusing on profitable "Bottom of the Pyramid" business models)
- Investors with reduced financial return expectations (e.g. social venture capital funds, clients of ethically-oriented banks using special saving accounts)
- Investors without financial return expectations (e.g. foundations, donors)

The first group of investors with market-rate financial return expectations focuses almost exclusively on financial returns but considers social issues as a constraint in their investment decisions. Investors without financial return expectations are focused on the social mission and do not demand financial returns in exchange for their investment.

At this point, there are two different views on the right funding mix. The authors believe that the focus on one set of return expectations and the subsequent alignment is the most appropriate solution for social enterprises especially for scaling up (Achleitner et al., in press; Foster & Fine, 2007). Some practictioners seem to have a preference to combine these different return expectations with the simultaneous use of grants and commercial capital. This view can certainly be a recommendation for the early stages of a social enterprise but once the social enterprise reaches a certain size the resulting conflicts increase. Although it might be rational, donors are hard to convince that a part of their donations may be used to pay the interest rates of a loan. The same thinking applies to banks which have a limited understanding of foundations' funding strategies and grant-giving patterns. Interdependent financing conflicts can arise as a consequence of these constellations.

As already outlined in the previous subchapter, there are potential conflicts between investors pursuing different return requirements (e.g. banks and donors) which we refer to as trade-off conflicts. There are also some conflicts related to the internal financing of social enterprises. An increase in public funding can lead to a reduction of private grants which is called the crowding-out effect. This effect can be caused by reduced fundraising efforts by the organization after the increase of public funding (Andreoni & Payne, 2011). That also explains why some government programs require the matching of public funds to mitigate this crowding-out effect.

Moreover, an increase of revenues often reduces the donations that a non-profit organization receives. James (1986) assumes that donors might not judge donations as still necessary once the non-profit organization generates its own income. Although both mechanisms for donor fall-off occur with non-profit organizations, they also seem to be relevant for social enterprises when they supplement their income structure with donations.

The third interdependent financing conflict relates to the restrictions of public funding programs. There is no generalizable classification but some public funding instruments restrict the external financing of social enterprises. They may restrict the payment of interest costs, or dividends for the capital providers, making it necessary for the social enterprise to look for alternative income streams to pay these capital costs (Achleitner et al., in press).

3.2 Market imperfections

3.2.1 Missing secondary market for equity investments

In a global analysis of 161 investments by social venture capital funds, 58.9% were equity-based, 19.6% were debt-based, 21.0% were a combination of equity and debt capital and 8.6% were hybrid financing instruments (Spiess-Knafl & Aschari-Lincoln, 2013).

In a survey conducted by the European Venture Philanthropy Association, the financial instrument portfolio was analysed. It was found that 72% were grants. Of the remaining 28%, 11% were equity-based, 9% were debt-based while the remaining 8% were guarantees, hybrid grants or other financing instruments (Hehenberger, 2012).

These two studies show that debt capital is a widely used instrument in the financing of social enterprises. It might simply be a reasonable investment strategy but part of this proportion seems to be driven by the fact that there is no secondary market for equity investments. Debt capital is the only investment method which enables the investor to recover the investment.

However, debt capital can be considered an impediment to growth. Debt capital requires that a social enterprise is able to generate predictable cash flows to cover the interest rates and to repay the principal. It seems that debt capital dampens the innovativeness and risk-appetite of social enterprises (Milligan & Schöning, 2011).

This is also confirmed in a survey of investors. 45% agreed and 30% strongly agreed that there is a missing secondary market for equity capital, as well as legal issues leading to a high proportion of debt-capital based investments (GHK, in press). The following table analyses the potential scenarios concerning this market imperfection.

What are the scenarios?

Scenario	Description
Negative	Triggers such as reputational damage to the social investment market (e.g. mission drift, fraud or outsized personal profits) may lead to a loss of interest from private investors in the social investment market. This could subsequently have a negative impact on the development of a secondary equity market.
Status Quo	A status quo with a modest growth over the next years means that investors have few possibilities to exit their equity investments which leads them to work on other structures which allow them a repayment of their investment.
Positive	There are currently a number of platforms being launched which could be an attractive exit option for social investors. Social stock exchanges are a possible exit route for social investors. It is also possible that cooperatives owned by clients or supporters, which would take over part of the equity investments, can be created. Finally, an increase in the number of social capital providers could enhance the secondary markets in the social finance sector. The EU-level financial instrument will add to this positive development.

Table 6: Development scenarios (secondary equity market)

3.2.2 Mismatch between sustainable and needed investment sizes

Almost all empirical evidence shows that European social enterprises are mainly active in the service sector. Activities in the service sector entails that social enterprises generally are not researching or developing new cost-intensive products which they are then manufacturing in their own facilities (Heister, 2010). This is borne out by the identified sectors as surveyed by the European Venture Philanthropy Association. Health represents 27%, Education (21%), Other (16%), Social Entrepreneurs in General (10%), Environment (9%), Housing (7%) and the remaining 9% being in culture/arts, law/advocacy, research and social services.

Social enterprises are thus mainly dependent on personnel costs. In health- or education-related concepts most of the costs are driven by personnel expenses. Although it may sound rather simplistic, business models of social enterprises are thus certainly less expensive than comparable start-ups in the for-profit sector with their focus on technology or consumer products, and with long periods before reaching the break-even point. Moreover, social enterprises are often supposed to mobilize resources of third parties (e.g. office facilities, IT-infrastructure, inexpensive licences).

The median investment size of venture philanthropy funds amounts to half a million USD in a global sample of venture philanthropy funds (Spiess-Knafl & Aschari-Lincoln, 2013). There are just a few investments in Europe with available and publicly disclosed figures but it can be assumed that a large number of the deals lie in the range of €200,000 to €500,000. Even though some investments exceed the threshold of €1 million, this finding is also backed by the investments sizes of European venture philanthropy funds. Weber & Scheck (2012) state the assets of BonVenture to be €15.7 million and of the Social Venture Fund to be €7.5 million. Oltre Ventures raised nearly €10 million from wealthy investors and aims for a larger fund as a next step (EVPA, 2011). These data points are all consistent but can change once the industry matures,financing needs increase or the next financing rounds occur.

Additionally, Agafonow & Glémain (2013) show that the transactions costs are rather high due to the uncertainties of the business models of social enterprises. Analysts need to understand the social as well as the financial aspects of a social enterprise and documents are often not readily available. Given that a fund has to cover personnel costs (e.g. one investment manager can work with 5 to 6 social enterprises), office and due diligence costs, and can charge around 2 or 3% as a management fee, the minimum fund size should reach at least €20 million in order to operate sustainably. However, increasing fund sizes are in contrast with the needed investment sizes and the authors are currently not aware of many social enterprises in need of investments which are higher than €1 million.

The two opposed effects are that social enterprises have rather low capital requirements while venture philanthropy funds need larger fund sizes to cover the relatively high transaction costs.

In a survey of social investors conducted by GHK (in press) 60% agreed and 20% strongly agreed that average investment sizes in social enterprises are rather small which leads to high fixed costs for each investment.

What are the scenarios?

Scenario	Description
Negative	After a couple of years with low rates of success, investors could start to retract their capital from venture philanthropy funds. This could lead to a situation where the number of venture philanthropy funds will be reduced.
Status Quo	In a status quo scenario venture philanthropy funds remain active in their same position operating at the current level.

Positive	In a positive scenario future average investment sizes will become larger as the industry develops. Social enterprises will possibly take more risk and aim for more expensive business models. More capital providers will enter the social investment arena and the EU-level financial instrument will contribute to this development.

Table 7: Development scenarios (investment sizes)

3.2.3 The matching of supply and demand

In interviews the authors have conducted with social entrepreneurs it is regularly noted that access to finance is a problem for the social enterprise. The same picture is painted in different studies. Social Enterprise UK (2011) conducted a study in the UK with 865 social enterprises (210 social enterprises via an online survey and 655 telephone interviews) and analysed the barriers for social enterprises. The four main barriers for start-ups sound similar to those of profit-oriented start-ups, namely lack of/poor access to/affordability of finance (45%), cash flow (22%), lack of appropriate skills/experience (19%) and lack of awareness of social enterprise among customers (15%).[9]

In a rather limited sample of 31 Austrian social enterprises, Lehner (2011) finds that 10% claimed to have sufficient funding for expansion, while 42% stated that funding is rather scarce. In a German sampleof 208 social enterprises participants with no external financing were asked about their access to finance. 32% answered that they could access the capital market while 68% stated that they have no possibility to take on equity or debt capital (Spiess-Knafl, 2012).

Although these findings are not exhaustive, they still indicate that the demand for capital is not met. One more factor is the investment readiness of social enterprises. It seems that social enterprises often are not “investment ready” as it is sometimes called. There is a large pool of capital willing to invest in social enterprises but the final investment remains complicated. There is often a lack of understanding on both sides, an unwillingness to pay interest rates, an orientation towards the so-called grant economy or a simple lack of necessary documents such as impact reports or business plans.

Analysing the supply side, it is remarkable that investors often state that they do not have enough investment opportunities. There is a lot of interest on the supply side demonstrated not only by the fact that well attended events for investors are held regularly but that publications, studies and reports are also published on a regular basis. Events are organized by the large fellowship organizations such as the Schwab Foundation for Social Entrepreneurship, Ashoka or the Skoll Foundation. Remarkable publications include Achleitner, Pöllath & Stahl (2007),

[9] The remaining barriers are difficulties in accessing/entering market(s) (12%), prohibitive commissioning / procurement with public services (11%), lack of access to or poor advice, lack of business support (10%), lack of cultural understanding among banks and support organisations (9%) and regulatory issues (9%).

O'Donohue, Leijonhufvud, Saltuk, Bugg-Levine & Brandenburg (2010), Palandijian (2010), Saltuk, Bouri & Leung (2011) or Weber & Scheck (2012). Moreover, banks are launching impact investment funds. Deutsche Bank established an Impact Investment Fund (Deutsche Bank, 2011). Berenberg and LGT together launched a social impact fund aimed at a fund size of GBP 30 million (Gosling, 2013).

Judging that these players act on the basis that there is a reasonable level of interest on the supply side, it seems that there is enough capital for the funding of social enterprise. We can thus speak of a mismatch between existing supply and demand.

In a survey by GHK (in press) of social investors only one investor disagreed with the statement that supply and demand are not sufficiently matched, leading to a funding gap for social enterprises. All remaining investors agreed and 2 strongly agreed. On a related topic 45% agreed and 41% strongly agreed that generally speaking, social enterprises lack investment readiness in terms of business planning or internal structures.

What are the scenarios?

Scenario	Description
Negative	In a negative scenario, current initiatives to match supply with demand will disappear thus leading to further problems for social enterprises to fund their business models.
Status Quo	In a status quo scenario, social enterprises will continue to invest a lot of time and effort in finding sources of capital and continue working within a patchworked financing structure.
Positive	As the market matures and various initiatives aim at launching new financial intermediaries, it is likely that this funding gap will be reduced. For social enterprises there is an increasing offer for support in writing business plans or setting up professional structures and reporting standards, thus leading to more professional structures among social enterprises. An increase in the number of financial intermediaries will increase the availability of investment opportunities.

Table 8: Development scenarios (matching of supply and demand)

3.2.4 Lifecycle cooperation

Another issue often discussed is the lack of lifecycle financing. Most of the financing by venture philanthropy funds or even grants by foundations are often based on a single financing period between 3 to 7 years. While a for-profit company may be able to refinance a loan and keep a constant capital structure, a social enterprise may have to repay the complete investment within the financing period. This fact increases financial pressure on the social enterprise.

Moreover, at this early stage of development in the social capital market there is little cooperation among the various players acting within the social capital market. There are some deals in which two social venture capital funds invest at the same time. To the knowledge of the authors there have only been a few deals in which foundations and social venture capital funds were actively working together.

55% agreed and 10% of the social investors strongly agreed that social enterprises have problems of lifecycle financing which means that once they receive an investment they cannot rely on a refinancing opportunity at the end of the financing period. However, assessment regarding this market imperfection seems to be more controversial as 5% of investors strongly disagreed and 30% disagreed (GHK, in press).

What are the scenarios?

Scenario	Description
Negative	A further reduction of lifecycle cooperation will lead to further uncertainty for social enterprises and thus increase the tendency to de-risk the business model.
Status Quo	The social investment market remains sketchy and cooperation among the financial institutions is non-existent. However, it is uncertain that foundations will actively engage with for-profit capital providers to find later-stage investors.
Positive	As the market matures it is likely that cooperation among the players in the social capital market increases. An increase in the number of initiatives such as the creation of learning platforms or new social investment market actors will lead to sustainable social enterprises able to achieve lifecycle financing of their operations.

Table 9: Development scenarios (lifecycle cooperation)

4 Delivery options

Within this chapter some general remarks are made, and three different delivery options presented and discussed for the different instruments. The delivery options either aim to mobilize capital for social investment through signalling effects, or reduce the risk of the investment to be more attractive for capital providers. The initial amounts for the funded investments and the guarantees are subject to market demand.

Aim	Increase the capital base, through a signalling effect for other investors	Facilitate lending for social enterprises, and reduce the risk for capital providers	Capacity building in the social investment market
Instrument	Investment Fund	Guarantees	Grants
Main Target	Venture philanthropy funds	Mainly banks but also foundations	Financial intermediaries and organisations with a focus on the development of the social enterprises
Amount	€38 million + €3 million	€40 million	€9 million

Table 10: Delivery options

Each instrument should be open to Member States in case they want to use the structures for their national social investment market with compartments in the overall funding program.

4.1 General conditions

4.1.1 Profit distribution

There are three different levels suggested for profit distribution by the social enterprise, namely 0%, 20% or 40%. In the view of the authors, any limiting of the distribution can always be circumvented through different mechanisms which are impossible to regulate. Investors may ask for advisory fees, deferred payments after the exit or an investment in subsidiaries.

A complete restriction of any profit distribution would possibly lead to even more debt capital investments which are less attractive for social enterprises. Therefore, a complete restriction of any profit distribution (0%) cannot be recommended. The recommendation for a 20% or 40% profit distribution is less clear and impossible to quantify due to a lack of data. A look at the dividends and share repurchases in the European Union may help to clarify the picture.

The median total payout ratio for those listed industrial companies which either pay dividends or repurchase shares lies in the range of 20% to 60% (von Eije & Megginson, 2008).

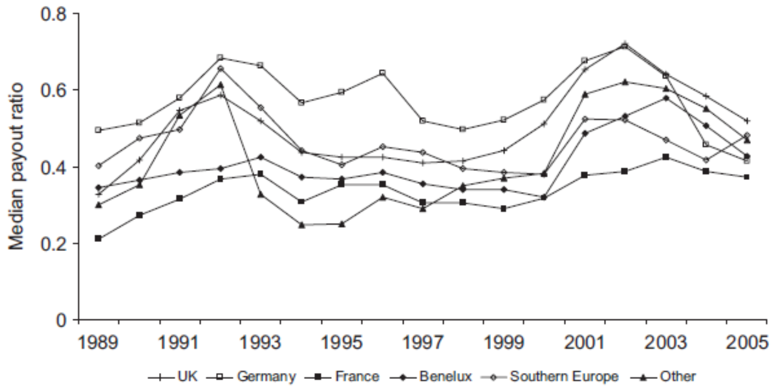


Fig. 9. Median total (cash dividends and repurchases) payout ratios for listed industrial companies in the EU15, that either pay cash dividends or repurchase shares, by country/region, 1989–2005. Companies from the United Kingdom are indicated by U.K., while German and French companies are indicated by Germany and France. Benelux represents companies from Belgium, The Netherlands and Luxembourg, "Southern Europe" represents companies from Portugal, Spain, Italy and Greece, and "Other" represents companies from Austria, Denmark, Finland, Ireland and Sweden.

Figure 2: Median total payout ratios

Source: von Eije & Megginson, (2008)

These findings are underlined by similar studies although they include the average payout ratio for all companies in the sample. Gugler (2003) finds an average payout ratio for 58 public and private family-controlled companies in Austria of 30.3%. Michaely & Roberts (2012) find for 44,673 private UK companies an average payout ratio of 25%.

It is obvious that the results of these studies are not really applicable for social enterprises as the companies in the sample might have a higher profitability and a different corporate governance structure. However, it can be observed that in no single year was the median payout ratio below 20%, and was often above 40%.

Based on the studies above as well as interviews and conversations with investment managers the authors judge that 40% would be a limit which would be acceptable for social investors. It seems that there is a general understanding that around half of the profit available for profit distribution seems to be what can be called a fair deal. 20% would probably lead to an increased use of debt capital. There should be no negative effects on the social targets of the social enterprise which could possibly occur on levels exceeding 50%.

As part of the regulation the authors recommend a 3-year rolling average of the profit distribution as there could otherwise be an incentive to pay out part of the profits every year.

4.1.2 *Investment Size*

The program also imposes a maximum investment size of €500.000 per investment on the social enterprise level. The authors understand this to be the maximum investment participation within the EU level financial instrument.

It is likely that banks or foundations would stay below a total investment size of €500.000 per social enterprise within their portfolio due to risk management considerations and guarantee limits. The median of the current investment of venture philanthropy funds is surely below €500.000 but there are already some investments exceeding this limit. Given that most investments were realized in the last years it is likely that the sum of all financing rounds probably will be substantially higher. The venture capital industry has also seen an increase in median fund sizes over the last decades.

Size Cutoffs (€ Millions)	Bottom quartile	Median	Top quartile	Mean	Observations
1980s	33	53	87	74	101
1990s	68	115	209	160	251
2000s	119	241	413	311	423

Table 11: Mainstream for-profit venture capital fund sizes[10]
Source: Harris, Jenkinson & Kaplan (2012)

An absolute limit of total investments per social enterprise at €500.000 would make funding by the European Commission less attractive and restrict the future development of the social capital market.

4.2 Guarantees

Guarantees are aimed at institutions providing debt capital to social enterprises. These institutions are mainly banks and potentially foundations.

Bank loans are already in place for non-profit organizations which use them to finance buildings or other long-term investments (Fedele & Miniaci, 2010; Spiess-Knafl, 2012). However, social enterprises are active in other fields where the business model is based on less stable revenue streams with fewer assets that they can use as collateral.

As outlined in the previous chapter a range of banks is interested in providing loans to social enterprises. As the financing decision and the interest rate are influenced by the default rate of the social enterprise a guarantee by the European Union could improve the financing landscape for social enterprises.

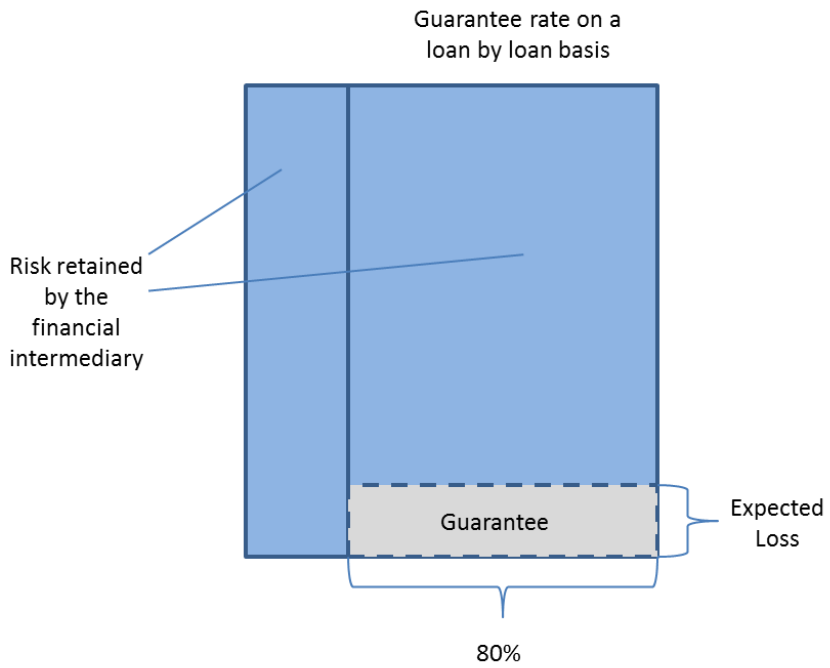
[10] The original fund sizes were given in USD and converted into EUR using the exchange rate average for each decade.

Foundations have significant assets which are designated to support the social good. Currently, the assets of the foundation are invested in the regular stock market and supporting social causes only with income from dividends, interest payments or capital gains.

An EU financial instrument could unlock this potential by guaranteeing the investments of foundations so that investment managers of foundations could consider social investments to be an attractive asset class. It would provide them with the opportunity to provide funding to those social enterprises that they already support within their grant-giving programs.

The expected default rates for social enterprises are rather difficult to estimate and there are no available data. The authors have analysed 43 banks with a focus on social activities although not-exclusively on social enterprises. Although the numbers are not consistently comparable as numbers are either based on bad loan provisions, write-offs, the percentage of non-performing loans or more general loan income, the evidence suggests that the default rate rarely exceeds 10%. As there is a high amount of uncertainty involved in the loan provision of social enterprises and therefore the authors suggest setting the guarantee rate at 80%. It is thereby further increasing the attractiveness for capital providers.

An indicative overview for a direct guarantee model could have the following structure.

<table>
<tr><td>Structure</td><td>The direct guarantee model provides credit risk coverage on a transaction by transaction basis. In line with other guarantee structures provided by the European Commission the instrument would include a guarantee cap rate and a guarantee rate.

</td></tr>
<tr><td>Eligibility Criteria</td><td>All financial intermediaries as well as institutional investors (e.g. foundations or family offices) which are providing loans to social</td></tr>
</table>

	enterprises as defined in the EaSI regulation are eligible to receive a guarantee. Criteria in regard to quality and experience remain.
Investment size	The maximum size of a loan provided to social enterprises covered in this model is EUR500,000. Capital providers are free to provide additional funding to social enterprises outside of the portfolio covered by the loan guarantee.
Reporting requirements	Financial intermediaries are obliged to follow the reporting requirements outlined in the agreement.
Profit distribution	Social enterprises benefiting from this guarantee are not allowed to distribute more than 40% of their profit to the shareholders. The basis of this condition is a 3-year rolling average in which the profit distribution is not allowed to exceed the 40% stated in the regulation.
Leverage effect	The leverage effect is calculated as follows for guarantees: Commitment appropriations (A): 40 Expected budget utilisation (B): 100% Additional resources re-used (C): 0 Maximum fees and operating costs (D): 2 EU average guarantee rate (E): 80% EU average cap rate (F): 10% Average ratio loan / guarantee (G): 1,0 % of eligible final recipients (H): 100% Amount of finance to eligible final recipients (I): (A x B + C – D) / E / F x G x H = (40 x 100% + 0 - 2) / 80% / 10% x 1,0 x 100% = 475 Leverage effect = I / (A x B) = 475 / (40 x 100%) = 11.875 The target leverage is thus 11.875 for the guarantee program depending on the final determinants as well as the expected budget utilisation.
Volume per financial institution	The volume per financial institution depends upon the loan portfolio size. The fund manager should aim for a balanced regional distribution.

Table 12: Indicative overview (Guarantees)

4.3 Direct investment

Direct investments are aimed at building the industry and helping European Social Entrepreneurship Funds (EuSEF) currently being established (European Union, 2013), or funds with a similar approach, to start their investment activities.

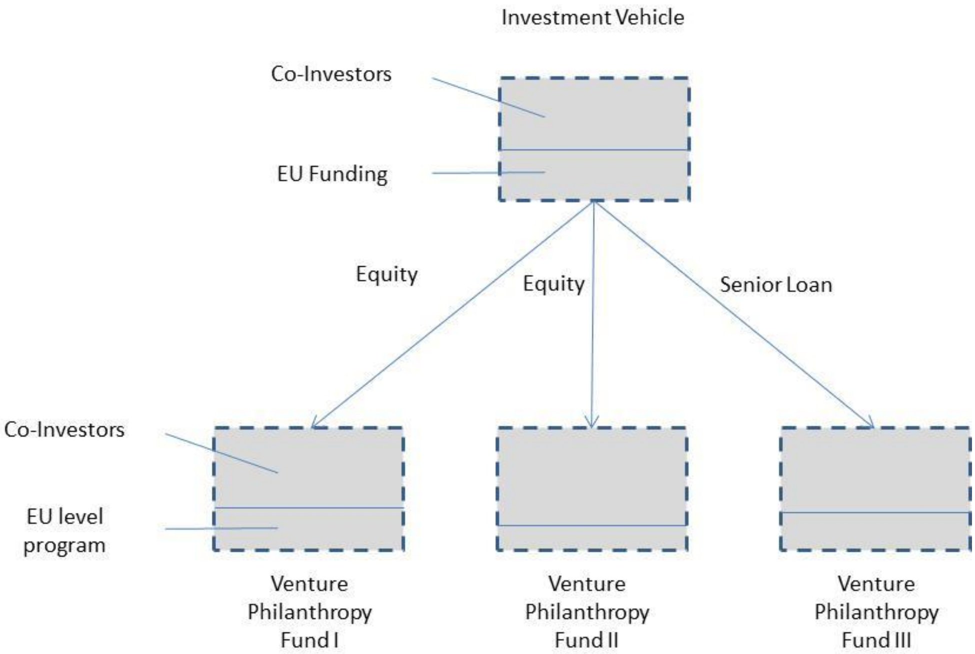
The current investor base of venture philanthropy funds which are comparable to those European Social Entrepreneurship Funds is rather small and in some cases even represented by a single individual. Funds could potentially widen the investor base and the European Union could send a signalling effect to other investors by directly investing in those funds. Moreover, a direct investment can increase the economies of scale and add to the efficiency of the industry.

It is difficult to evaluate the crowding-out effect of a direct investment. There is almost certainly a crowding-in effect caused by the signalling effect of a direct investment through a EU level financial instrument. This can also be seen as a quality label. However, an oversubscription by private investors cannot be excluded.

Given that the EU level direct investment has some restrictions such as reporting requirements, profit distribution and investment sizes it is likely that funds which are confident that they can raise enough private money will not consider this direct investment. Thus, crowding-out effects can be expected to be at a minimal level.

An indicative overview is provided below.

Structure	The fund manager of the program is providing debt or equity capital to the financial intermediaries eligible for funding through an investment vehicle managed by an organisation selected by the European Commission. This investment vehicle is open to co-investors. Within the structure of the investment vehicle the European Commission is taking a junior role (first loss provision) to make it more attractive to co-investors. At the level of the venture philanthropy fund, the conditions are *pari passu* with the other co-investors.

	 The program has an additional grant program to reduce transaction costs in the social investment arena. Up to 10% of the total funding should be reserved for direct grants for the financial intermediaries to reduce the transaction costs thereby further benefiting social enterprises.
Leverage effect	The funded instrument has a double leverage effect with co-investors on the fund of funds level as well as on the individual fund level. The leverage effect is calculated as follows for guarantees: Commitment appropriations (A): 38 Expected budget utilisation (B): 100% Additional resources re-used (C): 40 Maximum fees and operating costs (D): 5 EU average investment rate (E): 25% Average investment rate of financial intermediary (F): 90% Amount of finance to eligible final recipients (G): (A x B + C – D) / E x F x G = (38 x 100% + 40 - 5) / 25% x 90% = 262.8 Leverage effect = G / (A x B) = 262,8 / (38 x 100%) = 6.9
Grant component	The grants are supposed to lower transaction costs for each investment. Given a ~1:7 leverage and a ~10% grant component, the subsidy for each transaction amounts to 1.0% – 1.5% The subsidies will increase with a

	lower leverage and decrease with a higher leverage.
Eligibility criteria	All financial intermediaries as well as institutional investors (e.g. foundations or family offices) which are providing debt and equity investment within a fund structure to social enterprises, as defined in the EaSI regulation, are eligible to receive a direct investment. Criteria regarding quality and experience remain.
Investment size	The investment size is limited to €500.000 with regard to the participation of the EU level instrument. This sum increases proportionally to the leverage at the fund level that the investment size limit is not exceeded.
Reporting requirements	Financial intermediaries are obliged to follow reporting requirements outlined in the agreement.
Profit distribution	Social enterprises benefiting from this funded instrument are not allowed to distribute more than 40% of their profit to their shareholders. The basis of this condition is a 3-year rolling average in which the profit distribution is not allowed to exceed the 40% stated in the regulation.
Volume per financial institution	The volume per fund depends on market demand. The fund manager should aim at a balanced regional distribution.

Table 13: Indicative overview (funded instrument)

4.4 Grants

The main aim of grants will be capacity building within the industry. The main problems for social capital markets are high relative transaction costs, the low level of standardisation and cooperation in the social investment market, and the difficulty in setting up new financial intermediaries. The grants should not entail excessive reporting requirements and should be based on yearly lump sum payment. The authors propose three strands:

- Creation of new financial intermediaries
- Creation of support structures
- Creation of new learning platforms

Creation of new financial intermediaries

As outlined in the separate mapping study of the social investment market there are no financial intermediaries in a number of European countries. Although, there is interest in setting up new financial intermediaries, those institutions require significant investment before they are able to start their investment phase. The first part of the grants program would help to set up new financial intermediaries such as funds, but also perhaps, crowdfunding platforms for social enterprises with a certain sum.

Eligible are all organizations which aim to act mainly in the social investment market, have a feasible business model and funding strategy for the first years of their existence. The grant will be provided for 3 years for all eligible expenses such as personnel costs, infrastructure expenses or expenses for technical equipment. The financial intermediary can apply for grants of up to €100.000 which should be paid in two tranches at the beginning and the end of the first year.

Creation of support structures

GHK (in press) found that 86% of the investors agree that social enterprises lack investment readiness in terms of business planning or internal structures. However, this investment readiness is essential for social enterprises to receive funding from social investors. Therefore, the second part of the grants program focuses on creating support structures for social enterprises.

Those support structures include, for example, organizations which would provide business planning support or advisory services for social enterprises. The main feature of the structure would be the payment of €2.000 for every social enterprise which gets external funding from actors of the social investment market for the first time as a result of the activities of the institution. The institutions would be free to charge social enterprises additional fees. The creation of new support structures could also be supported with a one-time subsidy of €50.000. The organizations need to apply for grants based on a feasible business plan.

All these subsidies would be subject to certain requirements. The authors recommend the selection of a pool of organizations which would be eligible for these grants over the period of the financial instrument. This instrument will lead to lower prices for social enterprises and will benefit the social enterprise as it reduces the overall costs.

Creation of an EU-wide learning initiative

It seems that knowledge regarding reporting issues is available but there is a lack of any platform to support the diffusion of best practices. The third part of the grants program is therefore focused on the support for the creation of a platform for mutual learning and the diffusion of best practices. Furthermore, this organization would also evaluate the reported process of the EU level financial instrument.

One organization should be responsible for these tasks. The costs for this program are somewhat higher and would probably amount to around €150.000 per year.

4.5 Applicability for different mechanisms

The three different strands which are based on guarantees, funded investments and grants offer flexibility in the later use of the funds and can even endorse new financing mechanisms. The following box shows an illustrative financing mechanism:

Box 3: Testing the delivery options

The following example of a non-traditional financing mechanism shows the applicability of the delivery options.

Financing terms are often too expensive for social enterprises and a combined approach with equity and debt capital reduce the financing costs. A combined approach would combine the equity and debt financing of social enterprises to give them lower interest rates. This approach would address the financing gap between EUR100,000 and EUR250,000 which most studies identify.

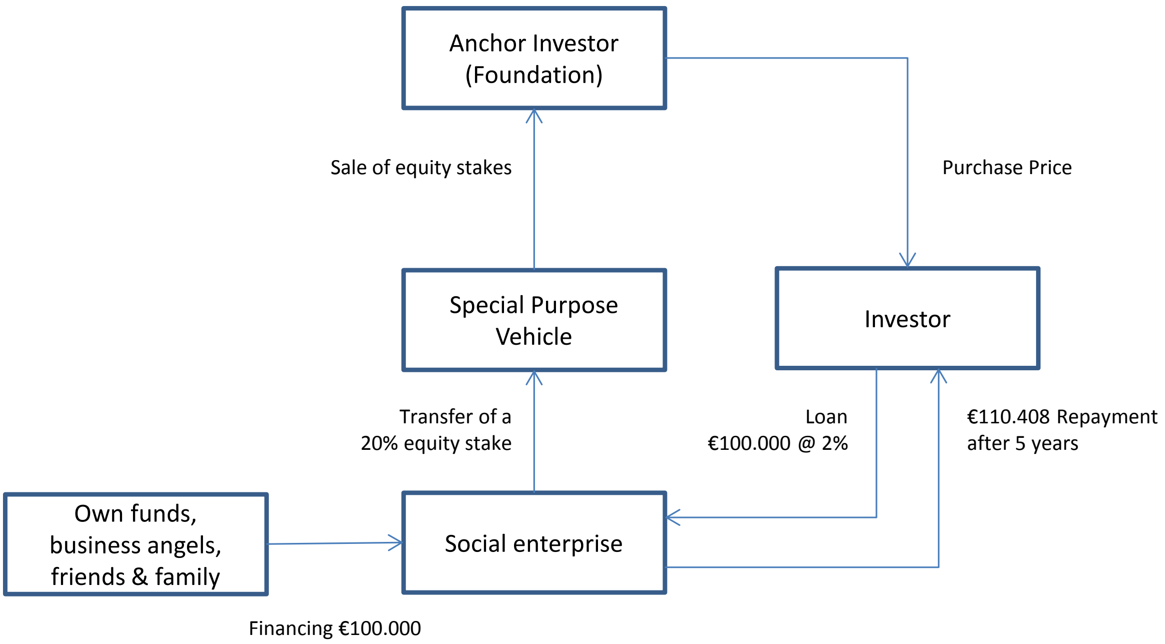


Figure 3: Illustrative financing mechanism

Source: Own illustration

The fund would operate using a matching approach. Every time a social entrepreneur raises EUR100,000 himself, the fund would double the amount. The first of three restrictions applicable for this funding is that the money be repayable after five years at a low interest rate. Additionally, the fund would get a seat on the board and a 20% equity stake. The additional equity stake and the low due diligence requirements allow the fund to offer low and attractive interest rates. The board seat would be filled using a voluntary approach where experts take the seat and support the social enterprise in achieving its social mission.

After 5 years all (up to 50) equity stakes would be sold to a foundation. This foundation would then become an anchor investor of the social enterprises or even resell these stakes at a later stage. The fund managers could access all three strands offered. They could apply for a guarantee of the loans, the funded instrument as well as grants for the set-up of the institution.

5 Performance measurement

5.1 Introduction

Recent years have seen significant changes in how funds are distributed and allocated for the pursuit of a social mission. Having faced criticism with regards to the effectiveness of their funding strategies, foundations and even development agencies are rethinking their strategies and try to measure their impact. New models of investment put a greater emphasis on selection criteria and impact assessment.

Given all these developments, impact assessment still remains a rather vague concept. Although a number of methods have been developed, reporting standards introduced and industry standards defined (e.g. Clark, Rosenzweig, Long & Olsen, 2004; O'Donohue, Leijonhufvud, Saltuk, Bugg-Levine & Brandenburg, 2010; Roder, 2010), there has been no acceptable method developed so far.

One of the main shortcomings of the current impact assessment methods is that there is no integrated approach for assessing the social impact. The problem seems to be that there is no relationship between the selection criteria in the investment process and the assessment of the social impact (e.g. for an overview of selection criteria see Achleitner, Heister & Spiess-Knafl, in press; Achleitner, Lutz, Mayer & Spiess-Knafl, 2011; Scarlata & Alemany, 2009).[11]

Standards developed and required by the funding program of the European Union could support the further development of the social investment market by providing a standard tool. The authors fully support the work of the GECES sub-group on Social Impact Measurement which is providing guidelines for the impact measurement..

5.2 Data requirement

At the level of the intermediary, there are two important measures. The main success factor of the program will be the mobilization of additional capital to facilitate the functioning of the social investment market. Thus, a first performance measure should take into account how much additional capital was brought into the social investment market. It should be the total capital raised by the financial intermediary. The other measure should be the number of social enterprises financed through the support of the funding program.

At the level of the social enterprise, there are a number of possible factors to determine the social impact. At the moment, there are two opposing views on which data social enterprises

[11] Typically, an investment decision would be based on a number of company-specific criteria such as the management team, the stability of the income streams or the business plan per se (Heister, 2010). That explains why a traditional portfolio of venture philanthropy funds or social investment funds has social ventures active in healthcare while others try to integrate disabled children with individual offers (Achleitner, Spiess-Knafl et al., 2011).

should provide. Some focus on a description of the impact and the story of the social enterprise. Others focus on the quantification of the impact of the social enterprise.

The authors propose a combination of both approaches which includes qualitative approaches such as the theory of change, a description of the stakeholders, and their benefits. Social enterprises and their capital providers should be free to decide which numbers they provide.

But there should at least be some measures to evaluate the overall impact of the program at least for a minimum of easily applied criteria. These should include enterprise-related figures such as sales at the time of the investment and after two years and number of employees (FTE). Moreover, there should be a statement of the theory of change. The social enterprise is free to choose additional company-specific criteria which they prefer to gather.

As the standards on impact measurement are evolving rapidly it is important that best practices are diffused on an open source basis made available for interested parties. The data received from social enterprises should be made available to researchers in this field. Members of the subgroup on social impact measurement could use this raw data to develop new and well calibrated impact measurement methods. After two years there should also be an evaluation of the first experiences to rework the reporting requirements if necessary.

Fund-level	
Capital raised	Total capital raised by the intermediary
Numbers of social enterprises financed	Number of social enterprises financed through the support of the funding program
Enterprise-level	
Sales	The amount of sales at the time of the investment, after two years and at the end of the reporting period
Employees	The number of employees at the time of the investment, after two years and at the end of the reporting period
Theory of Change	The theory of change of the social enterprise in their own understanding
Specific criteria	Additional criteria specified by the social enterprise or the financial intermediary

Table 14: Reporting requirements

Literature

The study is based on interviews, confidential material belonging to the interview partners, material provided by the European Commission for this study, unpublished work by the authors and the following literature:

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