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Guaranteeing Social Enterprises – The EaSI way

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Guaranteeing Social Enterprises – The EaSI way

Abstract[1]

This report summarises the current state of the external financing markets of the Social Enterprises targeted by the Employment and Social Innovation (EaSI) guarantee program managed by the European Investment Fund (EIF) and funded by the European Commission. The report starts by elaborating on the interpretation of what constitutes a Social Enterprise under the EaSI program. It goes on to provide an overview of the EaSI Social Enterprise sector in Europe and a discussion of its external financing market challenges. It furthermore discusses the initiatives undertaken by the EIF to address the challenges Social Enterprises face on the debt market. While the EIF has booked significant progress towards improving access to finance of Social Enterprises', a rough approximation of the unmet external financing demand on the market reveals that additional efforts are required to further close the social funding gap.

[1] We are grateful to Riccardo Aguglia, Samuel Clause, Cristina Dumitrescu, Per-Erik Eriksson, Cyril Gouiffes, Uli Grabenwarter, Salome Gvetadze, Helmut Kraemer-Eis, Frank Lang, Silvia Manca, Stefan Oberbichler, Dario Prencipe, Simone Signore, and Simone Uccheddu for helpful discussions, comments or suggestions. All remaining errors are our own.

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1 Introduction

The popular classical economic paradigm relies strongly on the notion of rational, maximising agents that look to increase their personal well-being. By construction, these agents are selfish, interested primarily in monetary rewards and pursue solely their own goals and interests. This theoretical construct, although useful for analytical purposes, is not representative for all economic agents. Instead, some agents derive utility from serving a purpose other than personal gain. Among entrepreneurs, for example, there are agents that pursue certain social objectives. These entrepreneurs go on to create *Social Enterprises*. The European Commission (2011) interprets a *Social Enterprise* as an operator in the social economy whose main objective is to have a social impact rather than make a profit for its owners or shareholders, while operating in a market-driven environment. The definition of a Social Enterprise is contested and we discuss this issue below. This study takes the Commission's definition of Social Enterprises as a starting point and goes on to discuss the financing challenges associated with this subset of Social Enterprises.

Social entrepreneurs are important actors in modern society. This holds true for a number of reasons: First, Social Enterprises drive social innovation (Austin et al, 2006). Just as entrepreneurship is widely regarded to be the driving force behind economic growth, *social* entrepreneurship can act as a driver for social progress. It provides innovative solutions for social issues, by using management ideas and business practices from the private sector. Second, Social Enterprises are better equipped than central governments to address local social needs. This is because the conception of Social Enterprises is generally rooted in the social structure of local economies, as most of its stakeholders are embedded at the local level (Borzaga and Defourny, 2004; Borzaga and Tortia, 2009). This local anchorage increases their ability to create tailor-made solutions for social issues, while taking into account local traditions and preserving the interests of local stakeholder groups. Third, in times of austerity, Social Enterprises can provide cost-efficient solutions to fill the policy voids created by the suspension of public social programs. In the aftermath of the financial crisis, this factor has become particularly relevant. In summary, Social Enterprises' market-driven approach can complement public policy efforts in combatting income inequality and achieving inclusive growth.

Importantly, Social Enterprises are typically less grant-dependent than their traditional third sector counterparts. They rely on external financing markets to pursue a self-sustainable financing strategy. Hence, the growth and development of the sector is crucially dependent on well-functioning finance markets. Unfortunately, access to finance has been identified as one of the most important obstacles for the continuous development of the sector (Brown & Murphy, 2003; Perrini & Marino, 2006; Wuttunee et al., 2008; Ridley-Duff, 2009; Bugg-Levine et al., 2012; Spiess-Knafl & Jansen, 2013; Kickul & Lyons, 2015). This paper discusses the challenges faced by Social Enterprises, falling under the above mentioned definition, on the debt market and summarises the policy action that was undertaken in the context of the European Commission's Programme for Employment and Social Innovation Guarantee Financial Instrument (EaSI GFI).

2 The actors on the Social Enterprise financing market

2.1 Social Enterprises: an essentially contested concept

The question of what exactly constitutes a Social Enterprise has been the subject of a rigorous debate in the academic literature. The debate on semantics has been waging for more than a decade. Up to this date, consensus on the exact definition has not yet been reached. In an agreement to disagree, Choi and Majumdar (2014) dubbed Social Entrepreneurship 'an essentially contested concept'. In this context, it is important to note that this paper covers only a subsegment of the total spectrum of Social Enterprises, as it revolves solely around the interpretation of Social Enterprises that was put forward by the European Commission in its Social Business Initiative (SBI), an initiative launched in 2011 to meet with the specific challenges faced by the rapidly expanding sector.[2] The European Commission's definition relies on the pioneering research of the EMES International Research Network.[3] EMES views a Social Entrepreneur as someone who voluntarily commits her entrepreneurial talent to mobilise private resources with the primary aim of creating social value, while essentially operating in a market driven environment (see Box I). By using this exact definition, the European Commission implicitely assumes there exists a trade-off between profit and social value creation, which motivates their restriction on profit-distribution. This proposition is not generally accepted in the market, neither by scholars, nor by market participants, and might as well cause problems for the design of policy instruments – in particular in the area of equity impact investing. Grabenwarter & Liechtenstein (2011), for example, argue that there exists a significant subset of Social Enterprises for which no trade-off exists.

The contested nature of the definition of Social Enterprises implies that statistics on the development of the Social Enterprise sector are rare at best. This makes quantifying the size and evolution of the sector a notoriously difficult task (Lyon and Sepulveda, 2009; Dart et al 2010). In a mapping study initiated by the European Commission, Wilkinson et al. (2014) meet with this challenge and document the current state of the Social Enterprise sector in Europe by comparing the European Commission definition of Social Enterprises to local definitions and legal structures.[4]

Using the European Commission's Social Enterprise definition, Wilkinson et al. (2014) estimate that per 2014 the total number of Social Enterprises operating on EU territory ranged in between 91,778 and 277,926. The geographical distribution of the European Social Enterprises is illustrated in Figure 1 and Figure 2.[5] Both in absolute numbers (Figure 1), as well as normalised per million of inhabitants (Figure 2), the Social Enterprise sector is most developed in Germany and the United Kingdom (620 and 618 Social Enterprises per million of inhabitants, respectively[6]). Together, these two countries host more than half of the European Social Enterprise sector. Also Italy, together with the UK often considered to be the cradle of Social Entrepreneurship (Defourney

[2] This definition formed the basis of the interpretation of Social Enterprises upheld by EIF's EaSI program. For more details, see Chapter 4.
[3] EMES was formally established as a non-profit association in 2002 and named after its first research programme: "the emergence of Social Enterprises in Europe" (English) and "L'EMergence des Entreprises Sociales" (French).
[4] No reliable data was available on the number of Social Enterprises in the Baltic States.
[5] An exhaustive list of the number of Social Enterprises per country can be found in Annex I and II.
[6] Evalutated at the average of the lower and upper bound estimates.

& Nyssens, 2010), hosts a large concentration of Social Enterprise activity, as well as France. The remainder of Social Enterprise activity is scattered across Europe. Especially in a number of (South)-Eastern European countries the sector remains relatively underdeveloped. In Greece, for example, there are only 23 Social Enterprises per million of inhabitants. This is surprising, since the demand for social goods and services tends to be higher in lagging peripheral regions. A similar observation can be made for Bulgaria, where there are only 43 Social Enterprises per million of inhabitants.

Box 1: European Commission's definition of Social Enterprises

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

The Commission uses the term 'Social Enterprise' to cover the following types of business:[7]

- those for which the social or societal objective of the common good is the reason for the commercial activity, often in the form of a high level of social innovation,
- those where profits are mainly reinvested with a view to achieving this social objective,
- and where the method of organisation or ownership system reflects their mission, using democratic or participatory principles or focusing on social justice.[8]

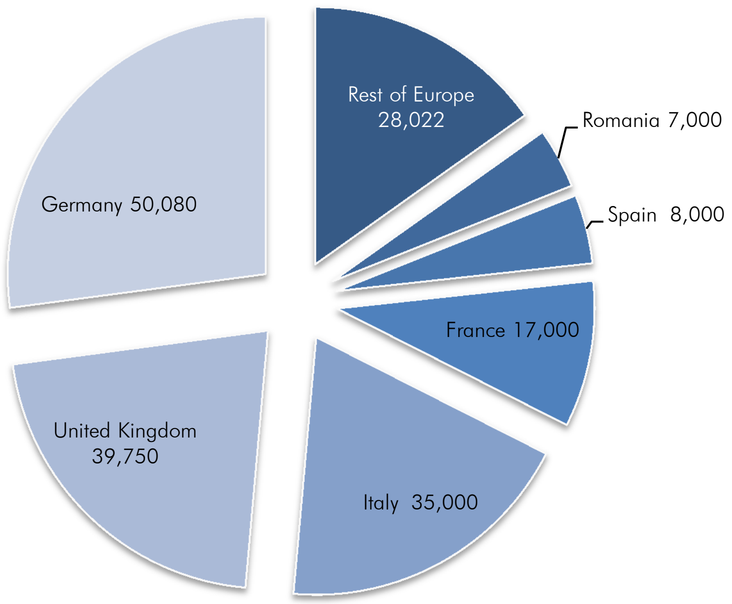
Thus:[9]

- businesses providing social services and/or goods and services to vulnerable persons (access to housing, health care, assistance for elderly or disabled persons, inclusion of vulnerable groups, child care, access to employment and training, dependency management, etc.); and/or
- businesses with a method of production of goods or services with a social objective (social and professional integration via access to employment for people disadvantaged in particular by insufficient qualifications or social or professional problems leading to exclusion and marginalisation) but whose activity may be outside the realm of the provision of social goods or services."

Source: European Commission (2011)

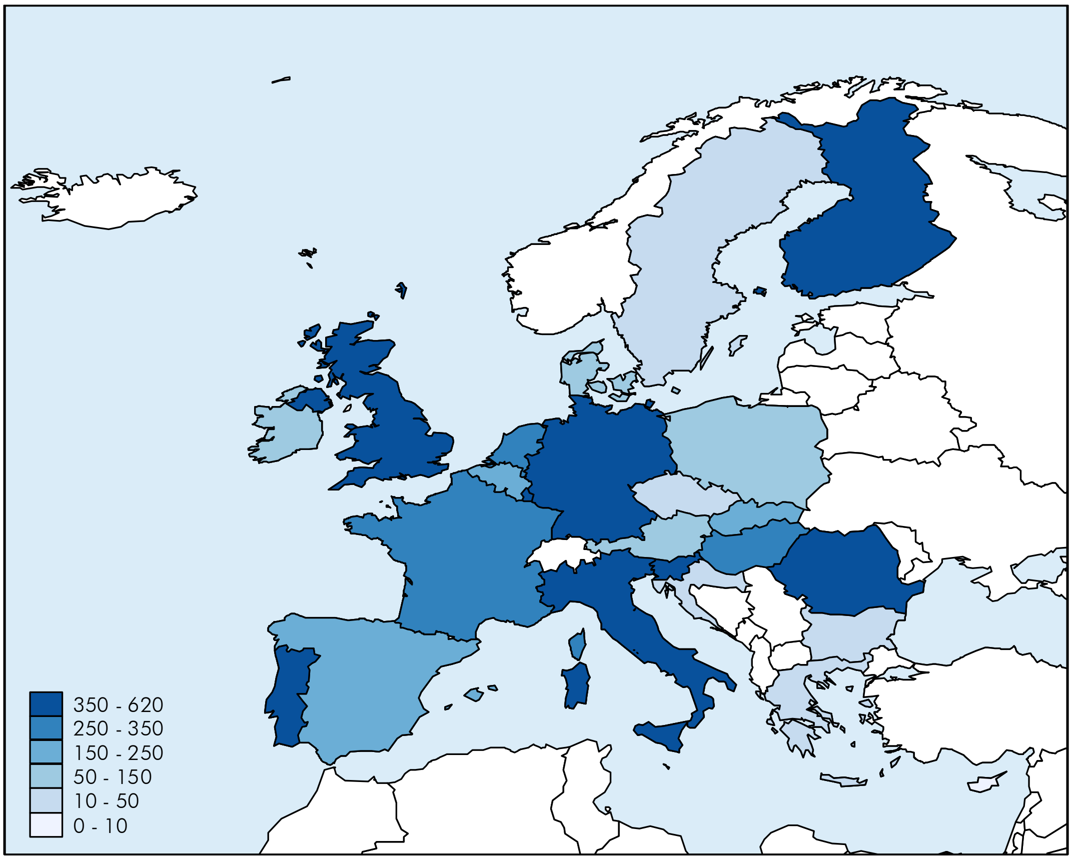
[7] Under the rules of the Treaty on the functioning of the European Union and the case-law of the Court of Justice of the European Union.
[8] For example, with a reduced range of pay.
[9] The list of examples provided by the European Commission (2011) is not meant to be exhaustive, as Social Enterprises can be active in any sector of the economy.

Figure 1: Geographical distribution of the 184,852 European Social Enterprises[10]



Source: Wilkinson (2014)

Figure 2: Number of Social Enterprises per million of inhabitants[11]



Source: Wilkinson (2014)

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[10] Evalutated at the average of the lower and upper bound estimates.
[11] Ibid.

2.2 Social Investors

Spiess-Knafl and Jansen (2013) categorise potential investor types from which Social Enterprises can source financing in three stylised segments: traditional investors with market return expectations, investors that will accept a return below the market average and investors without any financial return expectations.[12]

Traditional investors

First, consider the traditional market players who typically expect a market return on their investments. Although social value creation is not at the top of their priority list, they still serve as potential funding providers for Social Enterprises. Traditional banks, for example, are an important source of funding for Social Enterprises, and are sometimes preferred over ethical banks because they are able to offer lower interest rates (Medhurst, 2014). Even though the products of traditional finance providers are not explicitly tailored to their needs, Social Enterprises are free to apply for bank loans or credit lines through traditional financing channels. While this provides them with an extensive credit distribution network, traditional loan providers might not be well acquainted with Social Enterprises' business objectives, nor do they consider the social component in their output (Floyd & Gregory, 2016). This imposes restrictions on the availability of credit, vis-à-vis Social Enterprises.

Investors with blended return expectations

A second group of investors is driven by more than just financial motivations. These investors recognise that Social Enterprises generate *blended returns*[13] and value the social aspect of their activities. Consequently, they are willing to adapt their financial return expectations accordingly. Investors with blended return expectations find it important to have information on the expected social impact of a project, which is a central element at play in their investment decisions. Therefore, the availability of social reporting standards will be a determining factor in attracting funding from this investors class.

In this category, an important source of debt-finance are the ethical banking institutions.[14] They differentiate themselves from mainstream banks by focussing their lending activity exclusively on projects with a high social or environmental return (FEBEA, 2012). The business of ethical banking is a growing phenomenon across Europe and forms a crucial driver of the development of the Social Enterprise sector. Many of these social banks are cooperatives that carry out deposit-gathering and lending within a given group of individuals. This leads to a high degree of mutuality and a close bond to the local community. Other ethical banks have developed strategies in which clients may choose projects to which they allocate their savings, or alternatively select a wider field of interest, such as clean energy or social employment, for their funding to be invested in. There are two main networks of ethical banks: FEBEA (European Federation of Ethical and Alternative Banks and Financiers), which covers the European market and GABV (Global Alliance for Banking

[12] The categorisation is meant to be stylised and some investor groups are not easily categorised as such. For example, there exists a prominent group of investors that searches specifically for investments for which a trade-off between financial return and social return does not hold true (see Grabenwarter & Liechtenstein (2011), for a discussion).
[13] In which return is a blend of social and financial value creation.
[14] See table I for a schematic layout of their core characteristics.

on Values), which is the global umbrella organisation. FEBEA currently has 26 members, among which there are cooperative banks, investment companies and foundations, while GABV has 27. Having experienced significant growth over the past years, the federations together now cover circa EUR 130bn in assets (GABV accounts USD 100bn, whilst FEBEA EUR 30.5bn).

Table 1: Core characteristics of ethical banks

"Role"	*Work for the common good and ensure the right to receive credit through a bank activity consisting in raising funds and reallocating them in the form of credits for cultural, social and environmental projects.*
"Origin of Funds"	*Clients' savings, which are created through activities in the real economy. An ethical bank does not accept money that comes from illegal activities or controversial sectors.*
"Destination of Funds"	*An ethical bank addresses its collection/saving of money to socio- economic activities aimed at social, environmental and cultural profit. A special focus is dedicated to the weaker sections of the population and to the most deprived areas, favouring social integration and employment. Such banks do not finance activities in controversial sectors.*

Source: FEBEA (2012). What really differentiates ethical banks from modern banks?

Major players in the ethical banking space are, for example, Banca Etica and Banca Prossima in Italy, Credit Cooperatif and la Nef in France, GLS in Germany, and Charity Bank in the UK. Also Scandinavia has significant ethical banking activity: Cultura in Norway, Ekobanken in Sweden and Merkur in Denmark. Currently, the establishment of three new ethical banks is pending: Banco de Innovaçao Social in Portugal, EBanca in Croatia and Newb in Belgium. Interestingly, some studies have reported that the return to ethical banking is not significantly lower than is the case for traditional banking activities. In addition, their returns appear to be less volatile (GABV, 2015).

There are also a number of traditional banking institutions that have developed side-activities that specifically focus on social economy lending. Banks such as BNP Paribas, Royal Bank of Scotland, UBI Banca, ABM Amro, Deutsche Bank, Erste Group and UBS (Spiess-Knafl & Jansen 2013), all have products and services in place that specifically target the financing needs of Social Enterprises. A list of European ethical banks and traditional banks with social lending activities operating can be found in Annex III.

Investors without financial return expectations

A third potential financing source identified by Spiess-Knafl & Jansen (2013) are investors that hold no financial return expectations: the social value of the investment project is the only part of the return they value. Within this investor class, there are donors or foundations on the one hand and investors that expect capital recovery on the other. The latter segment has gained importance over the past number of years (Hehenberger, 2014). The contribution of investors that have credibly distanced themselves from financial return requirements decreases the riskiness for other investors (Bugg-Levine et al., 2012). However, their objectives sometimes conflict with those of traditional investors. This calls for additional effort to be invested in reconciling diverging interests.

3 Financing Social Enterprises

Studies on the financing decisions of Social Enterprises are rare, but the few studies that took up the challenge of analysing the external financing options of Social Enterprises are unanimous that Social Enterprises lack sufficient access to finance. This forms an important hurdle for the sector's development. Underdeveloped dedicated social finance markets are consistent with the observation that social economy organisations in general, and Social Enterprises in particular, finance themselves mostly through internal resources (own cash flow) and subsidies (OECD, 2015; Seforis, 2013). In this chapter, we first discuss some of the challenges faced by Social Enterprises on the debt-financing markets. We then provide an estimate of the financing gap faced by EaSI-type Social Enterprises. Because we consider only the subset of Social Enterprises that is covered by the European Commission definition, which face restrictions on profit distribution and therefore often rely more on debt financing, we focus on market failures on the debt financing market.[15]

3.1 Challenges on the debt financing market

The specific characteristics of the bank lending market pose significant challenges to SMEs in their search for external financing. By definition, Social Enterprises mostly belong to the category of SMEs and hence face similar challenges. Moreover, many of these challenges are magnified by the specific nature of Social Enterprise's business objectives.

Information asymmetries and lack of collateral

The infamous credit-rationing result, for example, as demonstrated by Stiglitz and Weiss (1981), is particularly relevant for Social Enterprises. This theory states that when confronted with information asymmetries, banks' profit maximising behaviour can lead to credit rationing, a situation in which supply of credit fall short of demand. Due to the peculiar and unfamiliar nature of Social Enterprises' business objective, the relationship between social borrowers and lenders is highly likely to be characterised by significant information asymmetries, arguably to a greater extent than is the case for traditional SMEs.[16]

In principle, this can be solved by pledging collateral. Collateral allows borrowers to reveal their true creditworthiness. However, just as the general population of SMEs, Social Enterprises often fail to meet the necessary collateral requirements put forward by traditional lenders. Collateral requirements are more problematic for Social Enterprises than for conventional SMEs due to the importance of grant funding in some Social Enterprise's financing strategy, since grant funders often stipulate as a condition that donations cannot serve as collateral to obtain debt financing (Peattie & Morley, 2008). This makes Social Enterprises more likely to fall victim to credit rationing.

[15] This is of course not to say that venture capital is irrelevant. On the contrary, equity forms an important cornerstone in the financing strategy of many Social Enterprises (Brown, 2006; Grabenwarter & Liechtenstein, 2011).
[16] For a recent discussion on the financing gap of SMEs, see Kraemer-Eis et al. (2016).

High fixed costs and small average investment sizes

Due diligence activities provide a direct way to deal with information asymmetries. However, screening costs associated with social investments are relatively high due to the nature of Social Enterprise business objectives. To judge the sustainability of Social Enterprise's business model, analysts need, in addition to screening the traditional financial metrics, also get acquainted with the social elements of the Social Enterprise's output. High screening costs combined with low average investment increases the average costs associated with lending to Social Enterprises. Therefore, traditional debt financiers looking for the highest possible return will prefer alternative low-cost investments.

Also from the perspective of the borrower, the small average investment sizes can form a hurdle for access to finance in general, and access to debt in particular. Wilkinson et al. (2014b) argue that many Social Enterprises lack investment-readiness. Therefore, to access certain credit products, growing Social Enterprises are first required to enhance their business expertise, by for example hiring an accountant. This is often problematic, given the relatively low average investment amounts.

Mismatch between supply and demand

While Social Enterprises see lack of finance as one of the main obstacles for growth, investors often state that they face a shortage of investment opportunities (Wilkinson et al., 2014a). Supply and demand mismatch can be driven by informational deficiencies or geographical disconnect between both sides of the market. This is especially relevant in case of Social Enterprises, who often operate on a highly localised basis (Santos, 2012). This implies that Social Enterprises are predominantly found in economically and socially deprived areas, where the need for their services is highest. If finance providers are not distributed geographically in a similar fashion as Social Enterprises are, there will exist a spatial disconnect between supply and demand.

Another driver of supply and demand mismatch are differences in national regulatory frameworks: diverging national policy measures regulating social investment funds could hamper the functioning of the EU's internal market. Heterogeneity in the portfolio requirement of investment funds, different levels of investor protection or national differences in information requirements would lead to geographical information asymmetries and results in an inefficient cross-border allocation of social finance supply.

3.2 The debt-funding gap in the Social Enterprise finance market

To quantify the exact size of the funding gap in the Social Enterprise investment market is a daunting task (OECD, 2015). A series of data challenges stand in the way of a proper estimation of the supply shortage of investment finance faced by the European Social Enterprise sector in its entirety. However, some back-of-the-envelope calculations can provide us with a rough, yet conservative estimate of the number of European Social Enterprises experiencing difficulties in access to finance, as well as an estimate for the total size of the annual unmet financing demand faced by the European Social Enterprise sector.

First, consider the approximation of *the number of European Social Enterprises that are facing difficulties on the external financing market*. Recall from chapter 2.1 that per 2014 the total number of Social Enterprises operating on EU territory ranged in between 91,778 and 277,926. Now, according to the SAFE survey of the ECB 30.8 percent of traditional SMEs in the Euro Area claim access to finance was a very important problem during the first semester of 2016 (Kraemer-Eis et al., 2016). Assuming that Social Enterprises in the EU28 face similar financing difficulties as the general SME population in the Euro Area, this implies that the number of Social Enterprises that consider access to finance to be an important issue ranges from 28,268 to 85,601. Arguably, these are conservative lower-bound estimates, given external financing is less accessible for Social Enterprises than it is for the general SME population.

Second, to get to a rough estimate of the *total unmet demand for financing* for the entire European Social Enterprise sector, we rely on a study provided by Big Society Capital (2013). The authors quote estimates for the total financing gap in the UK social investment market that range from GBP 300m to GBP 1bn, annually. To determine the share of the financing gap that relates uniquely to Social Enterprises,[17] one could use the information reported by the European Venture Philanthropy Association, which states that 32 percent of investments done by European Venture Philanthropy funds flows to Social Enterprises.[18] Assuming this share is the same for social investors other than Venture Philanthropy funds, and using the lower bound of Big Society Capital's gap estimates (GBP 300m, or EUR 345m),[19] this implies that the unmet financing demand for Social Enterprises in the UK amounts to EUR 126.4m. If one further assumes that this unmet demand is proportional to the number of active Social Enterprises in a given country,[20] it is possible to get an estimate for the EU28[21] as a whole. This assumption brings about that, on average, each Social Enterprise in the UK faces an unmet financing demand of EUR 2,777, annually.[22] This does not take into account that not all Social Enterprises are financially constraint. Distributing the unmet demand over 30.8 percent of Social Enterprises that report access to finance to be an important problem, one gets to an average annual finance gap of approximately EUR 9,000 per Social Enterprise, per annum. To calculate the European wide financing gap, the average unmet demand of EUR 2,777 per Social Enterprises is extrapolated to all other EU countries.[23] Summing up the resulting national funding gaps leads to the conclusion that that the entire European Social Enterprise sector is facing an unmet financing demand of EUR 513.1m, per annum.

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[17] The estimate relates to the *total* social financing market, and hence includes the demand for finance by organisations other than Social Enterprises, such as traditional third sector organisations.

[18] Note that this implicitely assumes that the gap on the social investment financing market is the same for Social Enterprises and other third sector beneficiaries, in relative terms.

[19] Evaluated at an exchange rate of EUR 1.15/GBP, an approximation of the exchange rate prevailing at the time of writing of the 2013 Big Society Capital study.

[20] This is likely to provide a lower bound estimate of the funding gap, rather than an overestimation. Since under-developed social finance markets constrains the development of the Social Enterprise sector, the funding gap per active Social Enterprise will arguably be larger in countries with a relatively small Social Enterprise sector.

[21] Excluding the Baltic States, for which no reliable information on Social Enterprises was available.

[22] Evalutated at the average of the lower and upper bound estimates of the size of the Social Enterprise Sector.

[23] This assumes the financing gap on the Social Investment market is the same for all EU countries. This assumption can be considered conservative and will lead to a lower bound estimate of the EU financing gap, as the UK social investment market is generally considered to be relative well developed, vis-à-vis other European countries.

4 European Policy Responses

4.1 Credit guarantees at the European level to alleviate the credit supply shortage

The analysis above shows the Social Enterprise credit market is characterised by market imperfections that justify public intervention. Well-structured credit guarantee schemes (CGSs), for example, can help closing the financing gap by replacing the need for collateral with credit protection provided by an external guarantor. A credit guarantee is a financial instrument in which a triangular relationship is formed between a lender, a borrower and a guarantor. The guarantor, typically in return for a fee, commits himself to repay the loan to the lender, in case of the borrower's default. While CGSs do not address the root of the market failure directly, they can increase the incentives of lenders to supply credit to Social Enterprises by providing a substitute for collateral.[24]

Public support to Social Enterprises through credit guarantees best proceeds at the European level. A European investment platform can address the geographical mismatch of funding on the Social Enterprise external finance market. The international geographical scope of EIF can be leveraged to improve coordination of national investment efforts and increase the efficiency of cross-country allocation of social investment spending. Furthermore, policy action at the European level offers the additional benefit of geographical risk diversification.

In addition, CGSs can accomplish a catalytic effect, by acting as a risk buffer for other investors at a more senior level. This way, limited EU budgetary resources are multiplied, which enhances the impact on targeted final beneficiaries (Bruhn-Leon et al., 2012).

4.2 EaSI - EU Programme for Employment and Social Innovation

Through the EU Programme for Employment and Social Innovation Guarantee Financial Instrument (EaSI GFI), the EIF is well-positioned to address the supply shortage on Social Enterprises' external financing market. EaSI is a financing instrument at EU level that promotes a high level of quality and sustainable employment, guaranteeing adequate and decent social protection, combating social exclusion and poverty and improving working conditions. The EaSI GFI builds on the success of the European Progress Microfinance Facility (Progress Microfinance) an EU initiative launched in 2010 and managed and implemented by EIF.

European Progress Microfinance Facility

The European Progress Microfinance Facility (EPMF) for employment and social inclusion was initially launched in 2010 as a joint initiative of the European Commission and the European Investment Bank Group. EPMF reached its investments closure in Q2 2016. Until then, Progress Microfinance has been implemented alongside the EaSI Guarantee Financial Instrument (GFI).

Progress Microfinance was a measure implemented in the context of the Europe 2020 strategy, which specifically targeted groups in precarious financial conditions (European Commission,

[24] For an elaborate discussion on the use of credit guarantees to alleviate the consequences of credit market failures, see Chatzouz, Gereben, Lang and Torfs (2017).

2014b) and is managed by the EIF. While the focus of Progress Microfinance was to establish and develop micro-enterprises by supporting micro-loans in general, the concept of micro-lending has an inherent social aspect. Increasing access to micro-loans typically benefits people who are unemployed, at risk of losing their jobs or are socially excluded from the traditional banking system (European Commission, 2014a). For example, 60 percent of supported final beneficiaries that were surveyed were unemployed at the time of loan application and 43 percent of respondents had income levels below the national risk of poverty threshold.[25]

Progress Microfinance has been implemented through two actions: 1) a guarantee instrument to providers of micro-credit, funded by the European Commission; and 2) a structured investment vehicle called the European Progress Microfinance Fund (EPMF), funded by the European Commission and the EIB. The latter instrument offers senior loans, subordinated loans (financing subordinated to senior creditors), risk-sharing loans (senior loans combined with risk participation in the micro-credit portfolio) and equity participation to micro-credit providers. The EU´s target commitment in EPMF was EUR 78m, matched by EUR 100m target commitment by the EIB (and further funds of other investors of up to EUR 47m). An indicative EU budget of EUR 25m has been allocated to the guarantee instrument.

As of end 2016, close to 100 transactions mobilised EUR 470m to support some 52,000 micro-borrowers, covering 23 countries. A posteriori, it is difficult to determine exactly how many of these final beneficiaries would qualify as Social Entrepreneurs. In 2014, an interim evaluation of the program was released which analysed the extent to which Progress Microfinance succeeded in facilitating micro-enterprises and Social Enterprises' access to finance. While the evaluation uncovered clear evidence of the effectiveness of the program in increasing access to finance to the general population of micro-enterprises, the evidence regarding the program's effectiveness to reach Social Enterprises remained inconclusive (European Commission, 2014b). This was due to the fact that specific support to Social Enterprises was not an explicit requirement for program participation. Although the social impact of Progress Microfinance was never under discussion,[26] only a minority of micro-borrowers sustained under the program were conclusively identified as Social Enterprises. Consequently, the report recommended exploring the possibility of targeting Social Enterprises specifically. This conclusion was in line with an earlier decision made by the European Commission (European Commission, 2011), which expressed the desire to further support the development of Social Enterprises as a new market segment (Bruhn-Leon et al, 2012).

EaSI - Microfinance and Social Entrepreneurship

Similar to Progress Microfinance, EaSI was founded in the context of the Europe 2020 strategy, to support the EU's objective of high-level employment, guarantee adequate social protection, fight against social exclusion and poverty and improve working conditions. The EaSI GFI is funded under the EaSI program and is managed by the EIF. It was designed to meet with the limitations of EPMF in the area of social finance and is specifically dedicated to promote access to finance among Social Enterprises. Under EaSI, intermediates can currently apply for a credit guarantee.

[25] For an elaborate discussion of the impact of Progress Microfinance on social exclusion, see Bruhn-Leon et al. (2012).

[26] Fourty-five percent of final beneficiaries were previously unemployed, 37 percent were female micro-entrepreneurs, and 18 percent of them had no or only primary education.

With the EaSI GFI, the EIF further intensified its efforts to increase access to finance for Social Enterprises.

How does EaSI support Social Enterprises?

The EIF does not provide direct financing to final beneficiaries; rather it supports financial intermediaries, who in turn provide financing to Social Enterprises. Financial intermediaries located in EU member states can apply for guarantees or counter-guarantees. For Social Enterprises to be eligible for support under the EaSI program, they are required to meet a set of criteria (see Box 2).

Box 2: EaSI definition of a Social Enterprise, from policy making to implementation

"Social Enterprise' means an undertaking, regardless of its legal form, 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."

During the early implementation phase of the EaSI Guarantee for Social Entrepreneurship, EIF, along with the EC, acknowledged some difficulties faced by financial intermediaries in determining the eligibility of a final recipient as a social enterprise. In fact, in the very first period of guarantee roll-out, several financial intermediaries experienced difficulties to assess on the basis of a final recipient's articles of association, statutes or by-laws whether or not an enterprise "has as its primary objective the achievement of measureable, positive social impacts" and therefore qualifies as a social enterprise as per above definition. A prospective client of an Intermediary may be a Social Enterprise as per the Intermediary definition but not having the proper language as per the eligibility criteria in its statutes or adequate constitutional documents. Annex IV elaborates on the guidance provided to the intermediary, with regard to the definition.

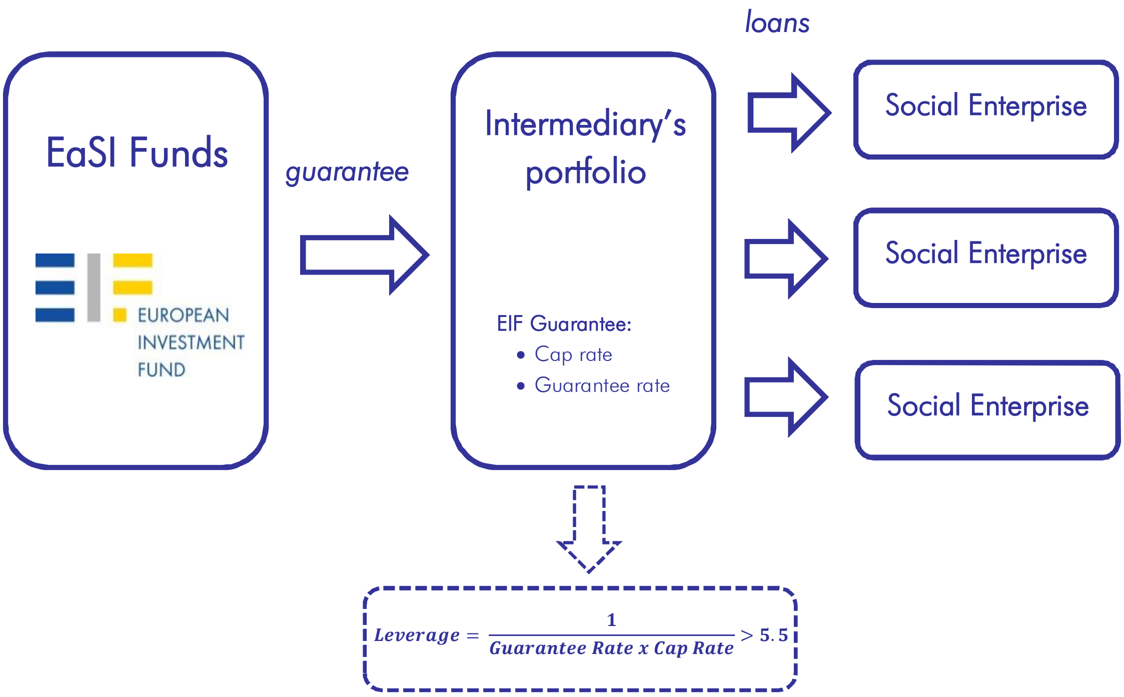
In order to remedy this situation, a specific Declaration has been elaborated jointly between the EC and the EIF and included in a new version of the EaSI contractual documents in order to make the Declaration an additional way of eligibility as a Social Enterprise once duly signed and approved by the relevant decision body.

Under EaSI, the EIF guarantees portfolios of debt financing products up to EUR 500,000 for Social Enterprises with either an annual turnover not exceeding EUR 30m, or an annual balance sheet total smaller than EUR 30m. A variety of debt-products are eligible for EIF support, such as loans, mezzanine loans, subordinated debt, leases and profit-sharing loans. Providing support for a wide range of products broadens the scope of the EIF to address different kinds of market failures. For example, Social Enterprises that operate under a legal form that prohibits equity financing are offered an alternative by supporting subordinated debt portfolios. Guarantees offer coverage of up to 30 percent of a total Social Enterprise portfolio (guarantee rate). EaSI shares social loans risk up to 80% of each credit (cap rate). The parameters can vary on a case-by-case basis but combined, they have to ensure a minimum leverage of 5.5x (which is the inverse of the product of the guarantee rate and cap rate). Guarantees will be made available for a period up to 60 months, but in practice average in between 24 and 30 months. They can also be delivered in the form of counter-guarantees. Next to guarantees, EIF also supports Social Enterprises through other debt products such as senior and subordinated loans. As is the case for the portfolio guarantees, their goal is to increase the credit made available to Social Enterprises throughout Europe. Senior loans are normally provided with a maturity up to 2-3 years. Figure 3 provides a schematic representation of the mechanisms underlying the EaSI GFI.

The total overall budget envelope made available under EaSI MicroFinance and Social Entrepreneurship amounts to EUR 190m. For the budgetary period 2014-2020, EUR 96m of which is attributed to the EaSI GFI, EUR 40m of which will be attributed to the promoting of access to finance for Social Enterprises (European Commission, 2015).[27]

Although the implementation of EaSI has only recently been rolled out, already seven portfolio guarantee agreements for Social Enterprises have been signed under the program, in five different countries[28] for portfolios totalling up to EUR 35m. While it is still too early to provide a full evaluation of the impact of the EaSI GFI on the development on the Social Enterprise sector, the EaSI GFI is expected to support 1,350 Social Enterprises by the end of the program (European Commission, 2015).

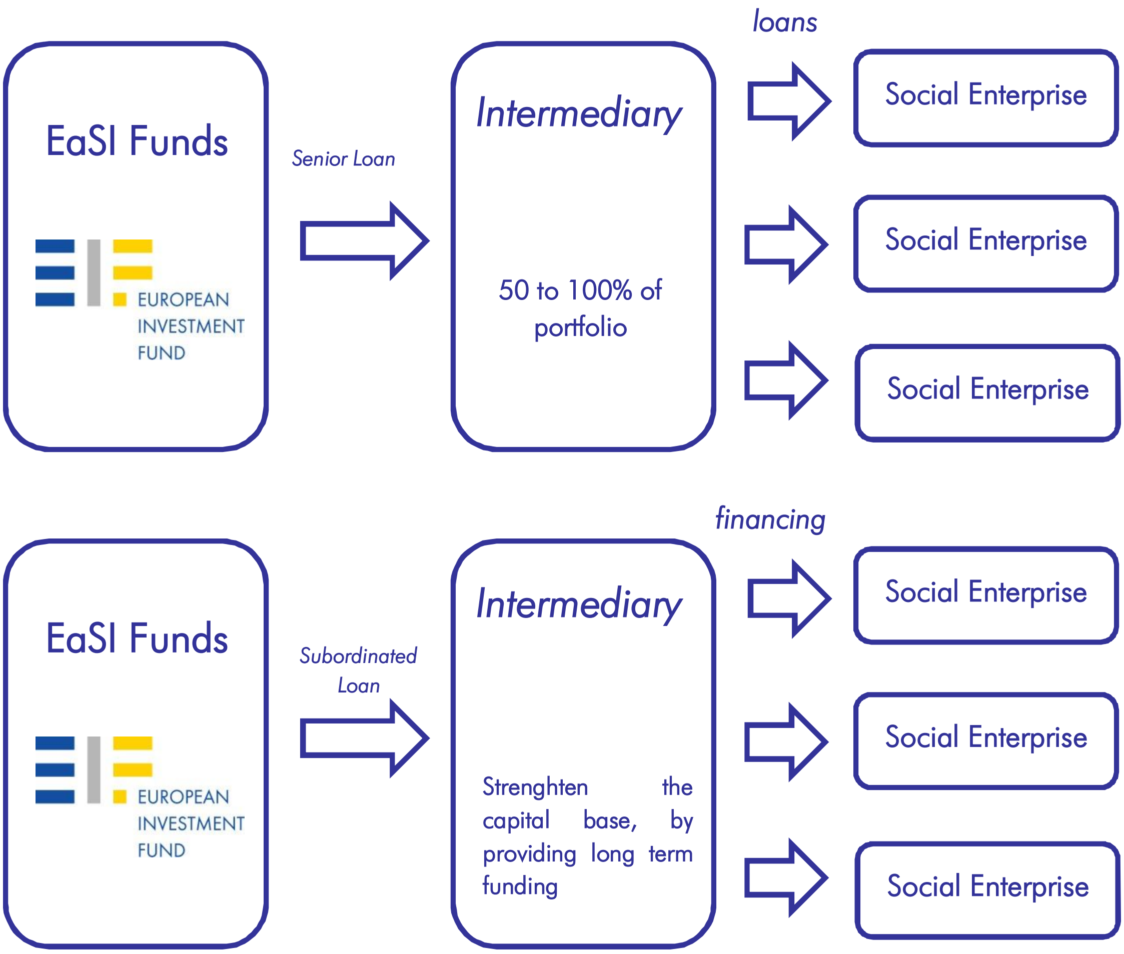
Figure 3: Schematic representation of the EaSI GFI and funded instruments



[27] And the remaining EUR 56m for microfinance in general.

[28] France, Spain, UK, Poland and Austria. In 2017, EaSI is expected to expand its support to intermediaries in Belgium, Italy and Denmark, further extending its geographical reach in supporting the European Social Enterprise sector.

Figure 3 continued:



Source: EIF

To track the social impact of the EaSI GFI and to avoid similar measurement issues that were encountered under Progress MF, the Commission has proposed an approach to measure the program's social impact in general, and impact on Social Enterprises specifically (European Commission, 2014c). The proposed approach follows closely the general principles of impact evaluation, and consists of a five step procedure:

1. Identify objectives,
2. Identify stakeholders,
3. Set relevant measurement,
4. Measure, validate and value,
5. Report, learn and improve.

5 Concluding remarks

The Social Enterprise sector uses a market-driven approach to contribute to social policy objectives. While the exact definition of what constitutes a Social Enterprise is contested, there is a general consensus that Social Enterprises can complement public sector efforts in combating income inequality and achieving inclusive growth. The growth of the Social Enterprise sector depends on well-functioning finance markets. Unfortunately, multiple scholars have identified lack of access to finance as an important obstacle to the sector's development. In this study, which focusses on the subset of Social Enterprises identified by the European Commission and implemented under the EaSI GFI, we reviewed some of the arguments that explain these obstacles. We discussed why information asymmetries are particularly relevant in the relationship between Social Enterprises and their potential lenders. Together with high fixed borrowing costs and a geographical misallocation of credit supply and demand, this implies that Social Enterprises face a significant financing gap. This study also provided an attempt to quantify this gap. We estimated that the number of Social Enterprises that consider access to finance to be an important issue ranges in between 28,268 and 85,601 and that each of these Social Enterprises faces an average unmet financing demand of EUR 2,777, annually. The size of the financing gap makes clear that, while significant efforts have already taken place under the European Investment Fund's EaSI guarantee instrument, additional efforts are required to further close the remaining financing gap on the Social Enterprise external financing market.

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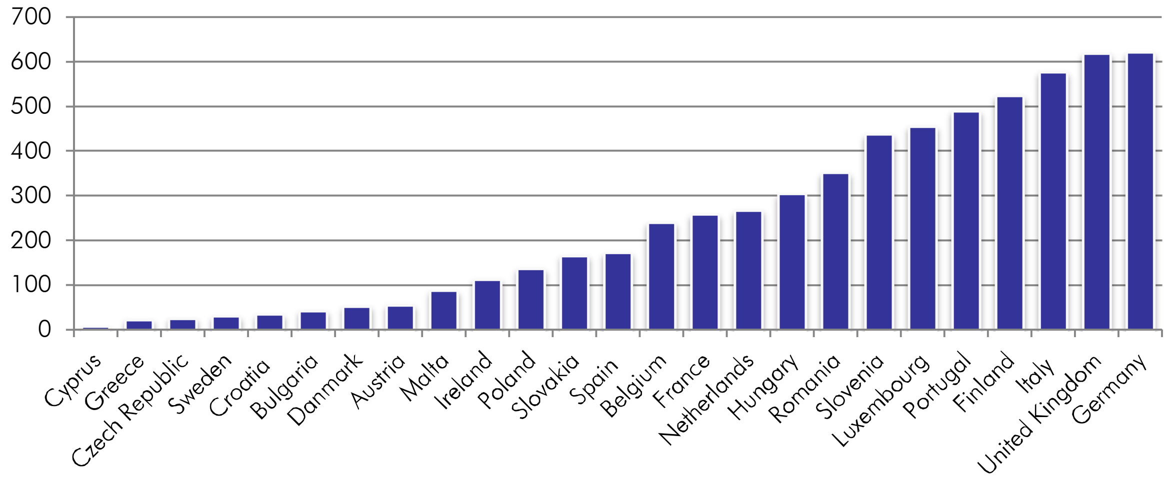
Annexes

Annex I: Number of Social Enterprises in Europe

Country	#Social Enterprises		Percentage of European total	#Social Enterprises per million of inhabitants (average min & max)
	MIN	MAX		
Austria	200	750	0.3%	56
Belgium	2,210	3,170	1.5%	240
Bulgaria	200	430	0.2%	43
Croatia	100	200	0.1%	35
Cyprus	7	7	0.0%	8
Czech Republic	250	300	0.1%	26
Denmark	300	300	0.2%	53
Finland	2,500	3,200	1.5%	523
France	6,000	28,000	9.2%	258
Germany	160	100,000	27.1%	620
Greece	207	300	0.1%	23
Hungary	3,000	3,000	1.6%	304
Ireland	520	520	0.3%	113
Italy	35,000	35,000	18.9%	576
Luxembourg	200	300	0.1%	455
Malta	25	50	0.0%	88
Netherlands	4,000	5,000	2.4%	267
Poland	5,200	5,200	2.8%	137
Portugal	5,099	5,099	2.8%	489
Romania	7,000	7,000	3.8%	351
Slovakia	900	900	0.5%	166
Slovenia	900	900	0.5%	437
Spain	8,000	8,000	4.3%	172
Sweden	300	300	0.2%	31
United Kingdom	9,500	70,000	21.5%	618
TOTAL	91,778	277,926	100%	369

Source: Wilkinson (2014a)

Annex II: Number of Social Enterprises per million of inhabitants[29]



Source: Wilkinson (2014a)

[29] Evaluated at the average of the lower and upperbound estimates.

Annex III: Social lending activity in Europe, some examples

Intermediary	Country	Tot. Outstanding (€)	Nr. of Loans	Average Loan Size (€)
Credal	Belgium	22,231,243	368	110,564
Hefboom	Belgium	22,530,112	360	62,584
Triodos	Belgium	1,158,000,000	2,875	402,783
Merkur Cooperative Bank	Denmark	1,231,890,000	3,007	409,674
Credit Cooperatif	France	11,987,681,000		
CS du Nord Pas de Calais	France	1,186,000	77	15,403
France active	France	52,000,000	7,021	7,406
la Nef	France	123,556,000	1,689	73,153
Triodos	Germany	210,000,000	1,999	105,053
Banca Etica	Italy	864,800,000	11,068	78,135
Banca Prossima	Italy	1,550,323,000		
Be Jeremie Campania	Italy	3,461,300	40	86,532
Be Jeremie Sicily	Italy	3,705,115	63	58,811
UBI loans to social SMEs	Italy	9,903,800,000	90,492	109,444
UBI Social bond	Italy	831,000,000	80	10,387,500
ABM Amro	Netherlands	4,780,000	4	1,195,000
Doen Foundation	Netherlands	18,172,738		
Triodos	Netherlands	2,179,000,000	32,121	67,837
TISE SA	Poland	34,000,000	740	45,946
SKLAD05	Slovenia	4,290,000	299	14,348
Triodos	Spain	826,000,000	6,133	134,681
Ekobanken	Sweden	516,331,000	400	1,290,828
Big Issue	UK	40,659,000	300	135,530
Charity and Aid Foundation bank	UK	22,362,450	33	677,650
Charity Bank	UK	216,460,926	823	263,014
Ecology Building Society	UK	153,842,814		
Royal bank of Scotland	UK	325,114,851	3,725	87,279
Triodos	UK	843,000,000	1,290	653,488
UCIT	UK	51,636,930	238	216,962
Unity Trust Bank	UK	253,441,100		

Source: Banks' annual reports

Annex IV: Social Enterprises: Guidance on the definition of Social Enterprises for intermediaries covered by the EaSI GFI

I. Entrepreneurial dimension

Criterion: Whether the organisation is engaged in continuous economic activity, i.e. in a continuous activity of production and/or exchange of goods and/or services.

This distinguishes the social enterprise from traditional non-profit organisations / social economy entities (pursuing a social aim and generating some form of self-financing, but not necessarily engaged in regular trading activity).

According to COM Regulation 800/2008 and the court ruling Case C-205/03 P FENIN vs. Commission, an enterprise or 'undertaking' is any entity engaged in an economic activity, regardless of its legal status and the way it is financed.

There is no limitation as to the legal form of the social enterprise. A social enterprise could take the form of a traditional company with equity, a cooperative, a foundation, an association, an NGO, etc.

II. Social dimension

Criterion: Whether the organisation exists to deliver public/societal benefit.

The key element that distinguishes a social enterprise from other types of undertakings is the purpose of the enterprise. When the primary objective of the organisation is the achievement of a social impact (i.e. the solution of a social or environmental problem), the enterprise can be labelled as social.

Having social impact as the primary goal makes the difference between Social Enterprises and companies that achieve a positive social impact incidentally, or that have a plan for Corporate Social Responsibility, but whose primary objective is different (i.e. the achievement of economic profit).

Social impact can be achieved in several ways:

Services or goods which generate a social return:

- A social return can be achieved if services or goods are primarily addressed to persons in a situation of exclusion, disadvantage or marginalisation, or that are vulnerable, for example affordable housing, equality and empowerment, migrants' integration etc;

- Or if the enterprise provides goods or services directed at total populations having a pre-emptive purpose that aims at reducing the possibility of the appearance of damage in the future, for instance in the field of early childhood education and care, active employment, health education and disease prevention and life-long learning, circular economy and sustainable development etc.

Methods of production that embody the social aim:

This is the case, for instance, where the main purpose of the enterprise is to provide people that are in a situation of exclusion, disadvantage, marginalisation or that are vulnerable, with a job or to integrate these persons in any form in the labour force. This should not occur incidentally; it should be the main purpose of the enterprise

NB: In this field, it is sufficient to tick "yes" for one of the ways in which social impact can be achieved to qualify as a social enterprise.

III. Governance dimension

<u>Criterion</u>: *Whether profits can/cannot be distributed.*

The fact that the main objective of the social enterprise is to achieve a social impact does not exclude the possibility of producing economic benefits. The profit will be mainly reinvested with a view to ensuring the achievement of the social objective:

If profits can be distributed, they must be subject to specific rules:

(a) the Social Enterprise must have achieved a substantial part or all of the ex-ante defined impact;

(b) the distribution must be in accordance with the Social Enterprise's predefined rules and procedures taking into account its social objective;

(c) such distribution must not cause the rolling average distribution during the last 3 years to exceed one third of profits over such period.

<u>Criterion</u>: *Whether the organisation has in place a system for measuring and reporting its social impact to stakeholders.*

Under the EaSI Guarantee, the social enterprise must comply with the following requirements:

- provide an explanation of outcomes and impact being targeted, for whom, and how they will be achieved (e.g. "theory of change");
- submit to the finance provider, a proposal for the measurement of the achievement of those outcomes (and that impact), unless such proposal is made by the finance provider;
- provide regular reports (preferably annually, but at least every two years) to the finance provider, of outcomes and impact achieved, using the measurement frameworks and indicators agreed with the finance provider;
- to agree with the finance provider, any changes, if any, after reconsidering, regularly, whether the measurement framework and indicators are appropriate.

Annex V: List of acronyms

- CGS: Credit Guarantee Scheme
- EaSI GFI: Employment and Social Innovation Guarantee Financial Instrument
- EC: European Commission
- EIF: European Investment Fund
- EU: European Union
- NGO: Non-Governmental Organization
- OECD: Organisation for Economic Co-operation and Development
- SME: Small and Medium-sized Enterprise

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