Which adequate financial ecosystem for social economy enterprises?

Spotlight on social economy enterprises that provide Services of General Interest and on work integration social enterprises

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This article reflects Social Platform's perspective in relation to the financial ecosystem of a specific segment of social economy enterprises: those that provide Services of General Interest (SGI) or work for the social and professional integration of people in vulnerable situations. Therefore, it does not intend to offer a comprehensive overview of the financial ecosystem of this sector as a whole. Some references are also drawn from my previous professional experience in social economy organisations in Italy.

Social Platform is the largest civil society alliance fighting for social justice and participatory democracy in Europe. Since its foundation twenty years ago, we have been advocating towards the European institutions to ensure that European Union (EU) processes recognise the specific role, objectives and features of SGI; for the well-being of people living in Europe, as well as social cohesion and economic value. Our focus has mainly been on social, health and education services, on which our members have expertise, both as organisations representing service users and non-profit providers of SGI. In addition, many of our members work for the social inclusion and integration in the labour market of people who face discrimination or are at risk of social exclusion.

Why definitions matter

In order to prevent confusion when talking about social enterprises and their financing it is important to have a good understanding of the various definitions. For example, the social economy (foundations, mutuals, cooperatives, and associations) is broader than social enterprises, but social enterprises are embedded in the social economy. Even if the Social Business Initiative (SBI) does not provide a legal definition of social enterprise, it sets three main broad criteria that have to be met for an organisation to fall into this category. These are:

1. A social or societal objective of the common good as the reason for the commercial activity.
2. Profits (surpluses) are mainly reinvested to achieve this objective.
3. The method of organisation or ownership system reflects their mission, using democratic or participatory principles or focusing on social justice.

A good starting point would be reaching a common agreement that these three criteria have to be cumulatively met.

In addition, the Rome Strategy[1] describes social economy as a plurality of organisational forms shaped by diverse national and welfare contexts, but with shared values, characteristics and goals. Social economy enterprises include cooperatives, mutuals, foundations and associations, as well as newer forms of social enterprises. In this paper we prefer to use the term social economy enterprises.

This premise gives me the opportunity to challenge some of the ways of conceptualising the term social enterprise that I have heard several times in discussions at EU level.

[1] The Rome Strategy is available at: http://www.socialeconomyrome.it/files/Rome%20strategy_EN.pdf

Several people, mainly from the financial sector or newer forms of social enterprises, consider that large organisations that work as established service providers on a non-profit basis are not social enterprises. If this were true, it would lead to the exclusion of important actors - such as diaconal organisations and welfare organisations - from the scope of social enterprises. It would also imply that some countries have practically no social enterprises (Germany, for example).

Another popular conceptualisation of the term is the tendency to privilege enterprises run by innovative, young social entrepreneurs (social entrepreneurship) over large non-profit providers - especially in the context of social innovation.

Additionally, I have heard distortions of the concept from representatives of the non-profit sector; if 100% of the surpluses are reinvested to achieve the social objective of the association, does this mean that it is a social enterprise?

All these different views are legitimate as they call into question the identity and scale of values of different organisational forms. Furthermore, they also demonstrate the extreme richness and variety of organisational forms that nurture social economy enterprises; a diversity of organisations that confront traditional and well-established actors with new ones. Therefore social economy enterprises do not only reflect the diversity of national and welfare contexts, but also the cultural diversity of different organisational forms that all deserve to be recognised.

These questions and interpretations are also the consequence of two very different sectors - the financial sector and social economy organisations - trying to develop collaboration, without speaking the same language.

Challenging some myths about the financing of social economy enterprises

These introductory considerations allow me to shed some light on the inadequacy of the financing framework for social enterprises that is being discussed at EU level – mainly framed by reflecting the financial market logic. In addition, often these discussions do not embrace many good practices from specialised financial institutions (ethical and cooperative banks, social finance, venture philanthropy, social economy own funds and financing instruments) that exist in some Member States.

One of the consequences of the financial crisis is that more financial institutions and private investors are interested in financing and investing in social economy enterprises. However, often this happens without a clear understanding of the nature, objectives and financial needs of social economy enterprises, as well as of the large variety of organisational forms that belong to this sector.

I will mention some recurring arguments that I have heard from representatives of the financial sector and the institutions that clearly show the lack of understanding of the sector. They also appear to be the direct application of business logic to social economy enterprises that are different from traditional businesses, including small and medium sized enterprises.

The first argument I want to challenge is that if an operator is funded solely by the means of public funding, it is not a social enterprise and it does not bear a financial risk. Social economy enterprises might be entirely or mainly funded by public sources because they provide a service of general interest or fulfil a public policy task (be it in the social, health, education, transport, cultural or environmental domains). Winning and implementing contracts with the public administration is an economic activity that entails financial risks, too.

Another myth is the following: the fact that non-profit organisations and social economy enterprises are prevented from making a profit makes it impossible for them to grow. In line with this reasoning, the G7 report "Impact investment: the invisible heart of markets" recommends governments to relax regulations that prevent social sector organisations from generating revenues.[2] We really hope that governments will not follow this recommendation, as this would mean changing one of the foundations of social economy enterprises: putting people and the general interest before capital. The reality is that many social economy organisations respond to the needs of their local community. They are very often non-scalable and do not want to be scalable. On the contrary, what they need from the financial ecosystem is to be supported when they need to develop new services and activities responding to new or old needs and challenges emerging in their communities (consider, for instance, the migration and asylum crisis). They need the right conditions to exist to meet the growing demand for social services, due to demographic and societal changes, the economic crisis, and increasing rates of unemployment, poverty and social exclusion, when public budgets are shrinking. They need to have a financial system that allows them to experiment with innovation, including social innovation, to ensure sustainable long-term financing (instead of short-term financing) and to complement their source of funding when public money is not available or payments are delayed by public administrations.

The last argument I would like to put forward is that the public sector has to shift from giving grants for the delivery of social services to paying for successful delivery of specific outcomes: this is the logic of impact investing. Of course, all initiatives, tools and methodologies that are able to improve the efficiency and effectiveness of service provision (such as measuring the social impact) are welcome. However, public authorities should remain accountable for the provision and financing of SGI even when they decide not to deliver them directly. It should also be borne in mind that in the social sector it is not always possible to gather and measure evidence in every single case. The same happens in the field of medicine, for instance.

Some key recommendations to develop an adequate financial ecosystem

In this section I will underline some key elements that should be taken into consideration while developing a financial ecosystem for the type of social economy enterprises we are focusing on.[3] This does not represent an exhaustive list.

The starting point should be that public funding is and will continue to be the primary source of funding for social economy enterprises that provide SGI. Therefore, when public authorities decide to delegate the provision of services to third parties – including social economy enterprises - they must retain responsibility for setting the legislative, regulatory and financial frameworks for service policy.

Public budgets must ensure adequate financial support for the provision of SGI, including social services, as this represents an effective investment for and an essential element of cohesive and resilient societies, in line with the Social Investment Package. SGI are an essential component to ensure social and territorial cohesion and a cornerstone of the European Social Model.

Member States and public authorities must ensure that non-discriminatory universal access to quality, affordable and accessible social services is guaranteed to all people living in Europe. Public authorities also need to ensure that services are available throughout the whole territory of a country, including rural and remote regions and for target groups with multiple and complex social needs.

[2] The report is available at www.socialimpactinvestment.org

[3] See Social Platform's position paper on the financing of social services and the conclusions of our joint conference on social impact investing; see the European Economic and Social Committee opinions on a financial ecosystem for social enterprises, on social impact measurement, and on social impact investing.

One may wonder how public budgets can suffice to do this in times of economic crisis. The availability of public budgets very often depends, at least in the long run, on fiscal policy choices. In fact, to ensure adequate public budgets for SGI, Member States and authorities should engage in fighting tax evasion and avoidance, undeclared work and corruption in public administrations. At national level, authorities should also undertake a revision of their taxation policies to ensure fairer redistribution.

Having said this, sources of private funding can complement public budgets, especially in countries hit hardest by the economic crisis. When private funders are involved, public authorities should ensure that donors and investors act in the general interest and that private financing is subject to high transparency requirements.

Access to financing should be ensured throughout the whole life cycle to support social economy enterprises both in the short and long run.

A gender perspective should be included while developing a financial ecosystem. One of the findings of the WEstart project[4] run by Social Platform member the European Women's Lobby is that women are more likely to start social enterprises than ordinary businesses. Social enterprises seem to allow a better work-life balance for women than traditional jobs. Many female social entrepreneurs have been motivated to start a social enterprise in response to personally experiencing an unmet social need in their communities. In this way, women-led social enterprises bring about social innovation. However, most of the female social entrepreneurs that were interviewed reported that the main barriers they encountered in setting up and running their social business are difficulties in accessing funds, lack of information about support structures and care responsibilities.

Financial support must be coupled with non-financial support, in terms of general guidance and business development support. When it comes to women, support mechanisms should also aim at strengthening their leadership and managerial skills beginning with enhancing self-confidence and increasing information and availability of mentoring programmes and support structures.

The funding of work integration social enterprises (WISE) varies a lot from one Member State to another. In some Member States WISE receive public funding, while in others public funding is not available for these kinds of activities. It should not be forgotten that some Member States still lack legal and regulatory frameworks for WISE. Therefore, the majority of WISE rely on a mixture of private and public sources of income. They very often run commercial activities as they sell the goods and services produced by their workers. In addition, they raise funds from foundations and other private sources.

Therefore, public authorities, financial institutions and foundations should promote the use of hybrid funds that are composed of both public and private funds. Existing good practices show that the public sector can provide public guarantee schemes, so that interest rates are lower and financial institutions or investors are more willing to invest without expecting a high return.

Another essential component of an adequate financial ecosystem is represented by favourable fiscal policies. Tax incentives, both to social economy enterprises, private savers and social finance providers, are very useful to support social economy enterprises in their mission of general interest, as well as to attract private capital. Now fiscal policies are more favourable to private investors than to social economy enterprises themselves. This should be reviewed in light of the competitive disadvantage faced by WISE and difficulties in accessing finance compared to traditional businesses. The social value they create in addition to the services they deliver, the goods and works they produce, should also be considered.

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[4] http://womenlobby.org/spip.php?rubrique440

Spotlight on public procurement, European Structural and Investment Funds, Social Impact Bonds and private financing tools

Public procurement:

When it comes to the financing of social and health services and of the social and professional integration of persons with disabilities and disadvantaged persons, public procurement plays a crucial role. The new Public Procurement Directive provides contracting authorities with a vehicle to achieve social and environmental goals.[5]

Public procurement can ensure a high level of quality in public contracts for social and health services, with the possibility to go beyond what is required by law.

Public procurement can also foster employment opportunities for people who are far away from the labour market. This is possible in different ways. Contracting authorities can restrict tendering procedures for works, goods and services to economic operators that have as their mission the social and professional integration of persons with disabilities and disadvantaged persons. These operators include social economy enterprises. This option is called "reserved contracts". Employment opportunities can also be achieved through the so-called "social considerations". If contracting authorities use the Best Price-Quality Ratio to award offers - instead of the lowest price or cost - the latter can be evaluated by weighting different criteria: social considerations, environmental considerations, quality, innovation and price or cost.

One good example is the decree that the city council of Barcelona issued to require its contracting bodies to make use of reserved contracts and social and environmental considerations in award criteria and contract performance clauses. With this decree, the city of Barcelona set the obligation to consider the use of social clauses and reserved contracts as the rule rather than the exception in tendering procedures.

European Structural and Investment Funds:

European Structural and Investment Funds (ESIF) – particularly the European Social Fund (ESF) and European Regional Development Fund (ERDF) – can play a transformative role in shaping social services and social infrastructures that is additional to the budgets of Member States. In particular, better complementarities between ESF and ERDF allow for the development of appropriate services around social infrastructures (for instance, renovation of social housing and training of residents on how to save energy).

The new regulations of ESF and ERDF include measures aimed at strengthening the institutional capacity of public authorities, as well as of stakeholders, in planning, organising, delivering or commissioning social services. They also allow for experimentation with innovation and the promotion of anti-discriminatory access to quality services.

Social Impact Bonds and other social finance tools:

Growing attention has been paid recently to Social Impact Bonds (SIBs) as instruments to finance social projects and social services. They differ from the classical public contract between a public authority and a service provider, as in SIB there are at least one or two additional parties involved: an intermediary (or so-called "delivery agency") and one or more investors from the private sector. The public administration takes a contract with the intermediary in which it specifies what should be achieved in terms of social outcome. The social intervention is carried out not directly by the intermediary, but by one or more service providers that are selected by the intermediary. The latter is also in charge of finding one or more investors that would bear the financial risk of the intervention; they

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[5] See Social Platform's guide "*Public procurement for social progress"*

get paid back by the public authority only if the intervention is successful, plus a return on the investment.

At Social Platform, we consider that SIB should not be used to finance social services in a mainstreamed way. However, in some cases they can be a useful tool to test interventions and perhaps to promote innovations, where government funding is not available.

Experts are divided on the question of whether SIB will improve social policy. Some highlight that SIB bring innovation to social services, while others argue that the innovative aspect consists in the coordination and integration of different actors.

Many think that SIB allow for saving public money, because public authorities pay only if the intervention is effective. While this may be true in theory, SIB are quite complex and the costs borne by the public sector to put in place such systems are quite high, in addition to paying returns. For example, Focus Ireland (a member of our members FEANTSA and Housing Europe) is involved in a SIB pilot project in Dublin to move 136 homeless families from privately-owned emergency accommodation into sustainable homes with social services support. After two years, the city of Dublin has not been able to find a suitable investor. Are investors really ready to take the risk when the innovative aspect is high? This case suggests that the answer is likely to be negative.

So far SIB have a limited geographical scope. In the EU you can find 29 SIB in the United Kingdom and one experiment each in the Netherlands, Germany, Belgium and Portugal. It is doubtful that they will be easily picked up in countries in which payment-by-result schemes are not in place. Finally, SIB are clearly not suitable for small non-governmental organisations. It is difficult to put in place SIB where there is not a pre-existing relationship of trust between the public authority, the provider and the investor. However, it is too early to draw conclusions as to whether SIB work or not. More time is needed for testing them.

Other social finance tools:

The discussions at EU level regarding private finance supporting social enterprises have mainly paid attention to social impact investment (including SIB), the European Social Entrepreneurship Funds (EUSEF) and the axis of the Employment and Social Innovation programme dedicated to social enterprises.

In this final section I would like to touch upon other instruments specifically designed for social economy enterprises that have been developed in some Member States by commercial banks, ethical banks, cooperative banks and development or guarantee funds. These tools are not very well known at EU level, despite the fact that they seem to repond better to the financial needs of social economy enterprises.

Some financial tools mobilise the savings of the population and their use should be spread more widely. For example, with the " social bonds" offered by UBI Banca in Italy[6], citizens decide to invest their savings in obligations that are devoted to social projects; similar systems exist in France and Austria to mobilise savings for social housing. Development funds are set up by cooperatives to promote and develop cooperatives and are funded by a percentage of cooperatives' profits.[7]

Other interesting initiatives come from the social sector itself. If you look at the social housing sector, in most EU countries public funding does not fully cover the costs involved in social housing provision. On the contrary, access to private funding – either through borrowing from banks or from capital markets - is gaining importance in its financing. For instance, in England, under the current Affordable Homes Programme, housing associations

[6] https://www.ubibanca.com/page/ubicomunita-social-bond
[7] See for example the Italian cooperative development fund set up by Law 59/92, CoopEst development fund, the Italian CGM Finance Consortium.

must finance 86% of the new construction cost for social housing, as only 14% of the cost is covered by government grant. Private borrowing used to be mainly from banks, but increasingly housing associations are issuing bonds as a way to raise funds. In the Netherlands, financing of new social housing projects by housing corporations mainly consist of bank loans (about 70-80% of the project cost on average), and housing associations' own equity. The Dutch state and municipalities come only as a last resort guarantor. In Finland, the social housing fund (ARA) grants public guarantees and interest subsidies on loans provided by the private sector for social housing construction.

In this article I have quoted only few initiatives. Many other initiatives and tools are available. The role of the EU should be to gather them and promote the exchange of good practices between Member States.