SOCIAL INVESTMENT MARKET IN SERBIA

CURRENT STATE
AND POTENTIALS
FOR THE
DEVELOPMENT

Implemented by:

smart KOLEKTIV

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ERSTE Bank

stepbystep

SOCIAL INCLUSION AND POVERTY REDUCTION UNIT

OKSIGEN LAB for social entrepreneurship

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The publication is developed within the project
Social Enterprise Financing in Serbia – Building Partnerships and Models for Sustainable Development of Social Finance Market.

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and potentials
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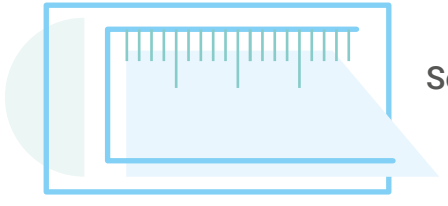
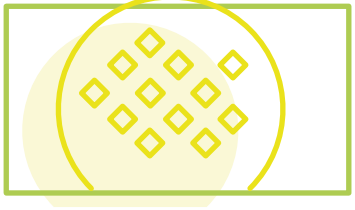
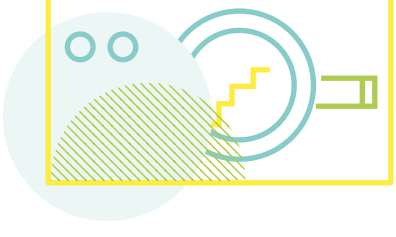
Content







Introduction

Social economy models started emerging during the past decade. Current estimation is that there are around 1200 social enterprises operating in Serbia. Although these organizations focus on positive impact on the society and provide innovative and sustainable solutions for numerous social challenges, they still face the lack of enabling environment for more intensive and impactful development.

One of the major challenges for social economy development in Serbia is access to finance. There is a growing amount of new social enterprises, as well as old ones, that wish to develop and scale up their business but do not have access to any adequate financial instruments. Sector predominantly relies on financing through grants, donations and subsidies. Available financial instruments provided by the state, development funds and commercial banks are not adapted to the specific needs of the social enterprises. They don't consider both financial and social aspects in an adequate manner and they are not flexible when it comes to different legal forms in which social enterprises operate.

Social (impact) investment approach addresses this lack of adequate financing. It considers both financial return and social impact and offers a variety of financial instruments that allow growth of business (production, sales, turnover) and impact (poverty reduction and prevention, support to vulnerable groups, nature preservation, etc.) at the same time.

Following the trend of social investment programs that are emerging within the European Union, and need of the sector for adequate financial instruments, Smart Kolektiv initiated the development of social investment market in Serbia. This publication provides overview of the current state of the demand and supply side in Serbia as well as impact investment instruments and best practice in the European Union. It also provides recommendations for the social investment market development gathered through wide consultative process with representatives of all sectors during 2017.

The publication is developed within the project ***Social Enterprise Financing in Serbia – Building Partnerships and Models for Sustainable Development of Social Finance Market.***

Smart Kolektiv is implementing the project in partnership with **Erste Bank** and **Oksigen Lab** during 2017 and 2018 with a goal to develop a Social Enterprise Financing in Serbia. The project is supported within the *EU Programme Employment and Social Innovation - EaSI (2014-2020) - Actions to boost the demand and supply side of the finance market for social enterprises.*

CHALLENGES AND NEEDS OF SOCIAL ENTERPRISES IN SERBIA

About the research

This research[1] was conducted in February and March 2017 aiming to, besides mapping the current challenges and needs of social enterprises, analyse in more detail their needs in regard to funding and readiness of social enterprises to be financed from different sources. Findings of the research that are to be found in the second part of this publication, were taken into account in defining recommendations for development of instruments targeting social enterprises. The research was implemented using the online questionnaire responded by 75 representatives of organisations and social enterprises. Following the analysis of the obtained data, 40 respondents that can be classified as social enterprises were selected.

The call for participation in the research was sent out using the existing networks of social enterprises available to Smart Kolektiv, SENS Network and Smart Kolektiv partner organisations. The data was processed on a sample of 40 social enterprises. Social enterprises participating in the research are guaranteed confidentiality, therefore all collected data is shown in a consolidated manner.

For the needs of the research and further analysis of data, social enterprises are defined as all legal entities acting following the principles of social entrepreneurship- small cooperatives, citizen associations, limited liability companies, craft shops, agricultural holdings, etc.

In our work, we have used the definition of social enterprises adopted at the level of the European Union: Social enterprises are focused on achieving positive impact in the community (social, welfare and environmental), rather than increasing capital. Enterprises producing goods or providing services in the market, in an entrepreneurial and innovative way. These enterprises often employ the most vulnerable categories of population (socially excluded persons). In this way, such enterprises contribute to social cohesion, employment and reducing inequality. (European Commission, 2017)

1 — The research was implemented by the Smart Kolektiv team

The sample structure

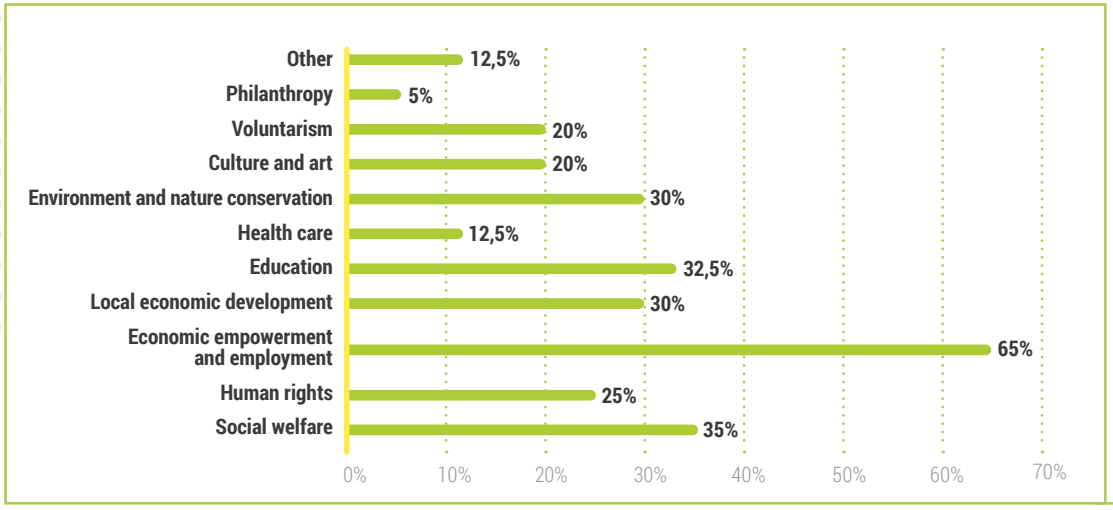
In regard to the **legal format**, within the surveyed sample 85% of the respondents were registered in the form of a citizen association, 12.5% are doing business in the form of a limited liability company, whereas 2.5% take the legal form of a sole proprietor.

According to the **year of incorporation**, 5% of the covered social enterprises were established before the 1990s, 7.5% during the 1990s, 50% in the 2000s, and 37.5% after 2010.

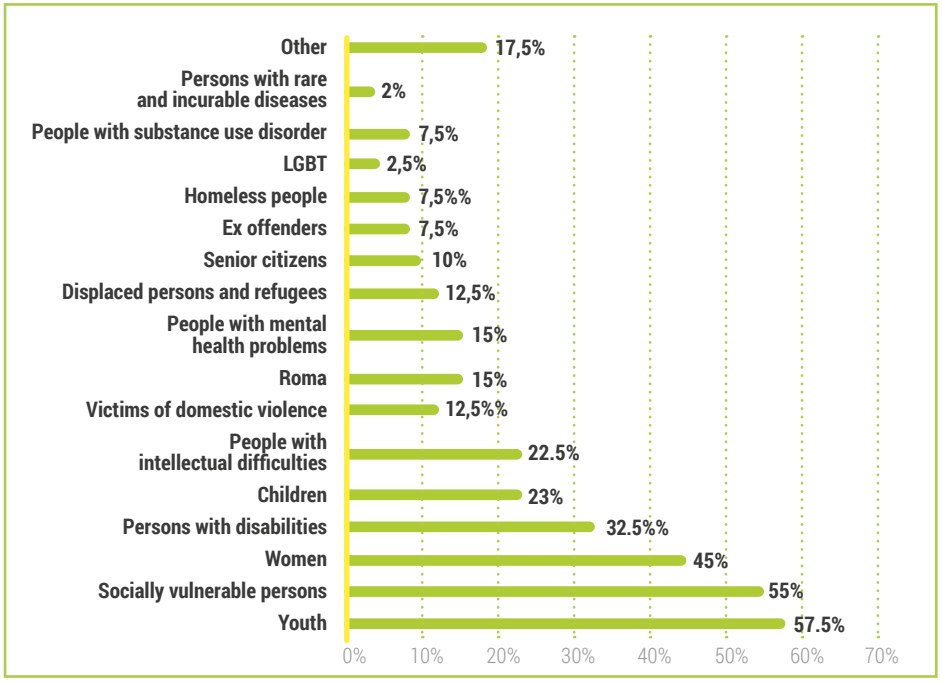
1. Social mission

The area of social impact

In terms of social impact, the respondents could choose up to 3 areas that are in focus of their action. According to the research findings, economic empowerment and employment is the area the participating social enterprises are most focused on, which is the case in 65% of the sample. Social welfare is the focus of 35% of the respondents, education of 32.5%, environment and nature conservation and local economic development 30% respectively, human rights 25%, culture and arts, same as volunteerism 20% respectively, health care 12.5%, and philanthropy 5% of the respondents.



SOCIAL IMPACT AREA

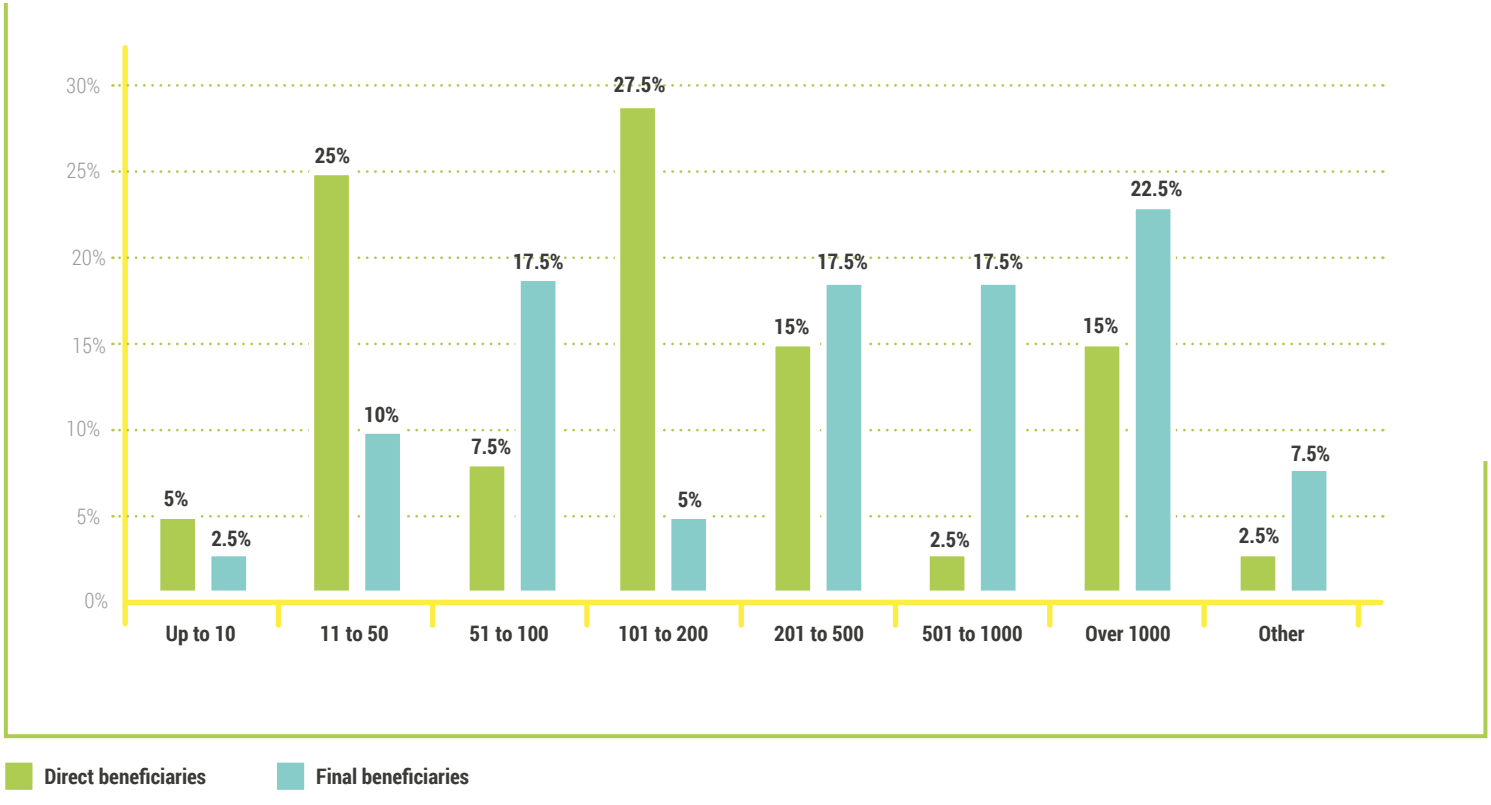


Target groups

In terms of the target groups, some of the social enterprises are focused on a single target group only (e.g. persons with intellectual disabilities), while others focus their activities on several marginalised groups. The participating social enterprises most work with the youth, which is the case in 57.5% of organisations. This is followed by 55% of social enterprises providing support through their activities to different socially vulnerable persons. Women are the target group for 45%, and the disabled are in focus of 32.5% of social enterprises.

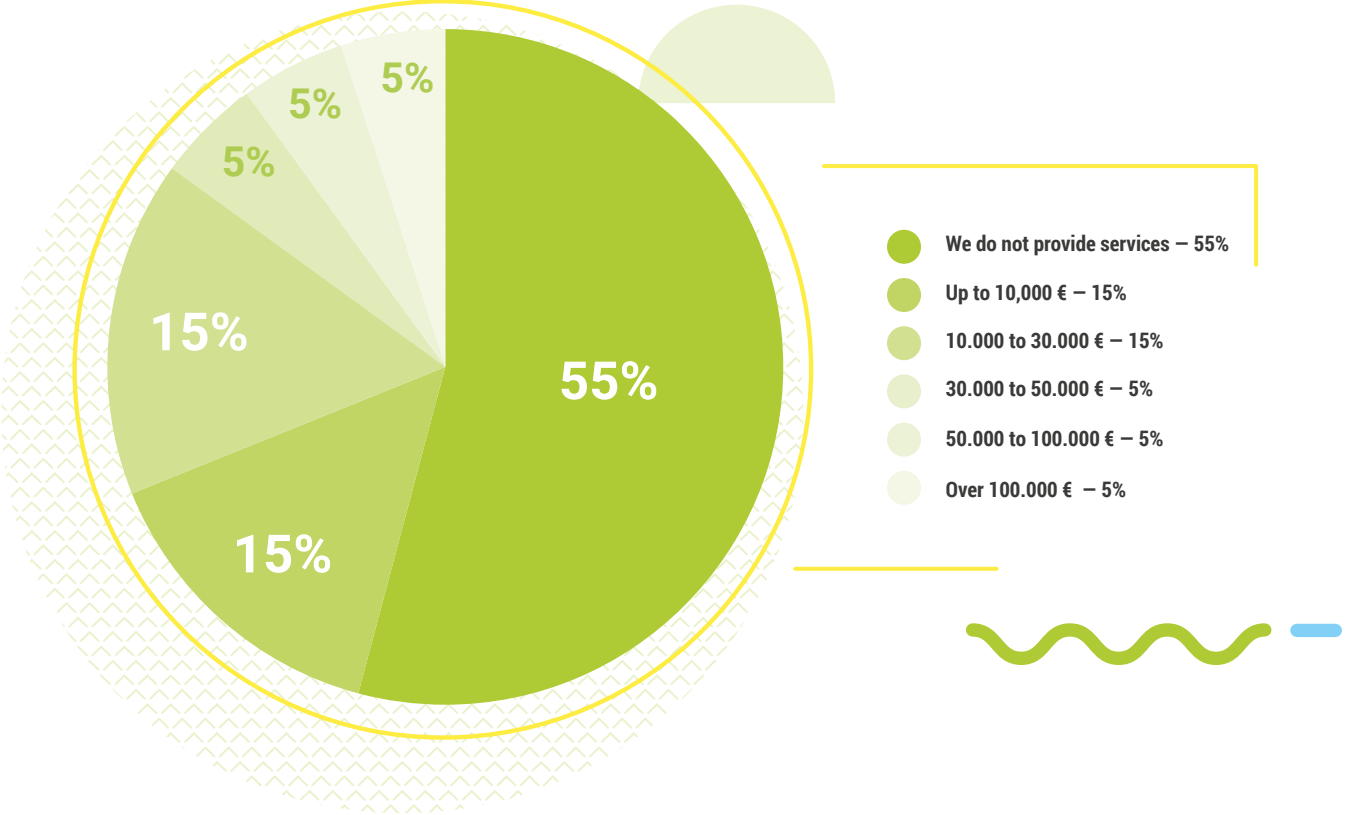
Direct and indirect (final) beneficiaries

The research has also covered a number of beneficiaries of social enterprises, both direct and final ones. Direct beneficiaries are those directly receiving a particular service of an organisation or social enterprise (e.g. users of day care for persons with intellectual disabilities), with indirect or final beneficiaries being all those whose quality of life has been improved by activities of a social enterprise (e.g. family and friends of primary beneficiaries, citizens, etc.). Depending on the type of the activity and specificity of the target group, same as on the place of the organisation's action and resources available, this range differs considerably. A majority of organisations have between 100 and 200 direct beneficiaries, which is the case with 27.5% of organisations, and when it comes to final beneficiaries, a major number of organisations have reported over 1000, which is the case with 22.5% of organisations. The scope of direct and indirect beneficiaries is presented in the Graph below.



The value of social services provided in the community

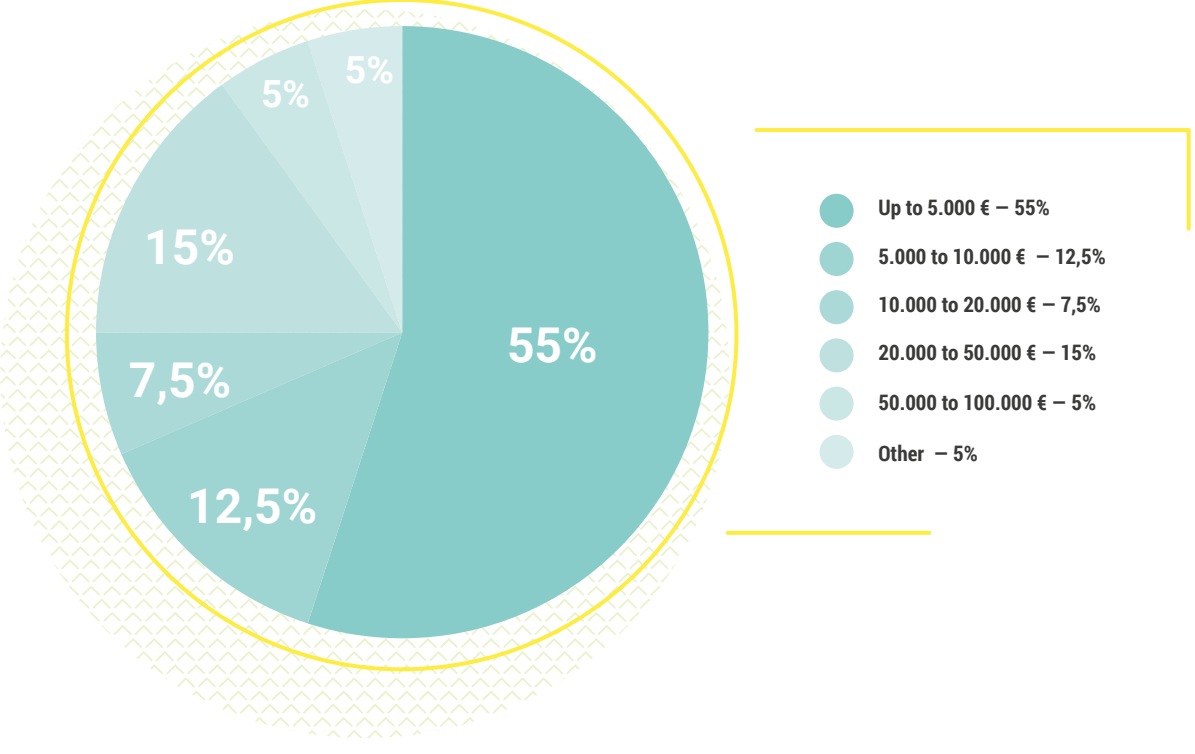
The participants in this research have also answered the question regarding the value of services delivered in the community in 2016. This question was answered by 45% of respondents, of which in 2016 15% delivered services amounting to EUR 10,000, with the same number of organisations providing services ranging from EUR 10,000 to 30,000.



2. Economic activities of social enterprises

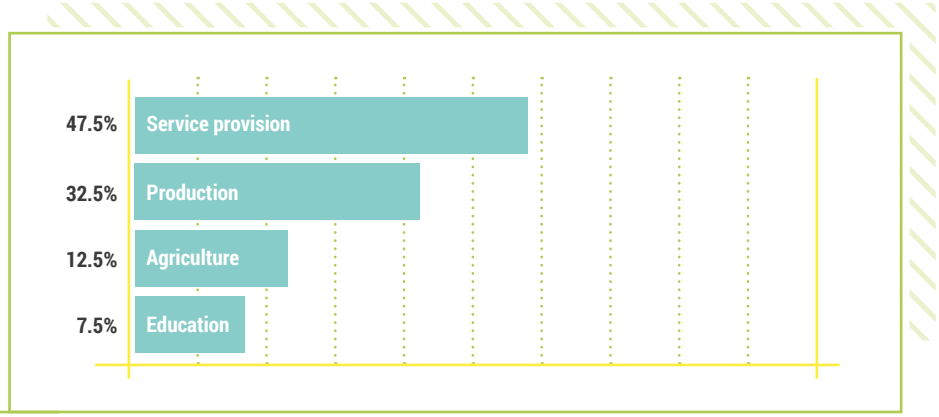
Income from economic activity

In 2016, majority of social enterprises generated income totalling to EUR 5,000, which is the case with 55% of responding organisations. Income ranging from EUR 5,000 to 10,000 was reported by 12.5%, while 7.5% of respondents declared income in the range between EUR 10,000 and 20,000. Income ranging from EUR 20,000 to 50,000 was reported by 15% of social enterprises, while only 5% of respondents declared income in the range between EUR 50,000 and 100,000.



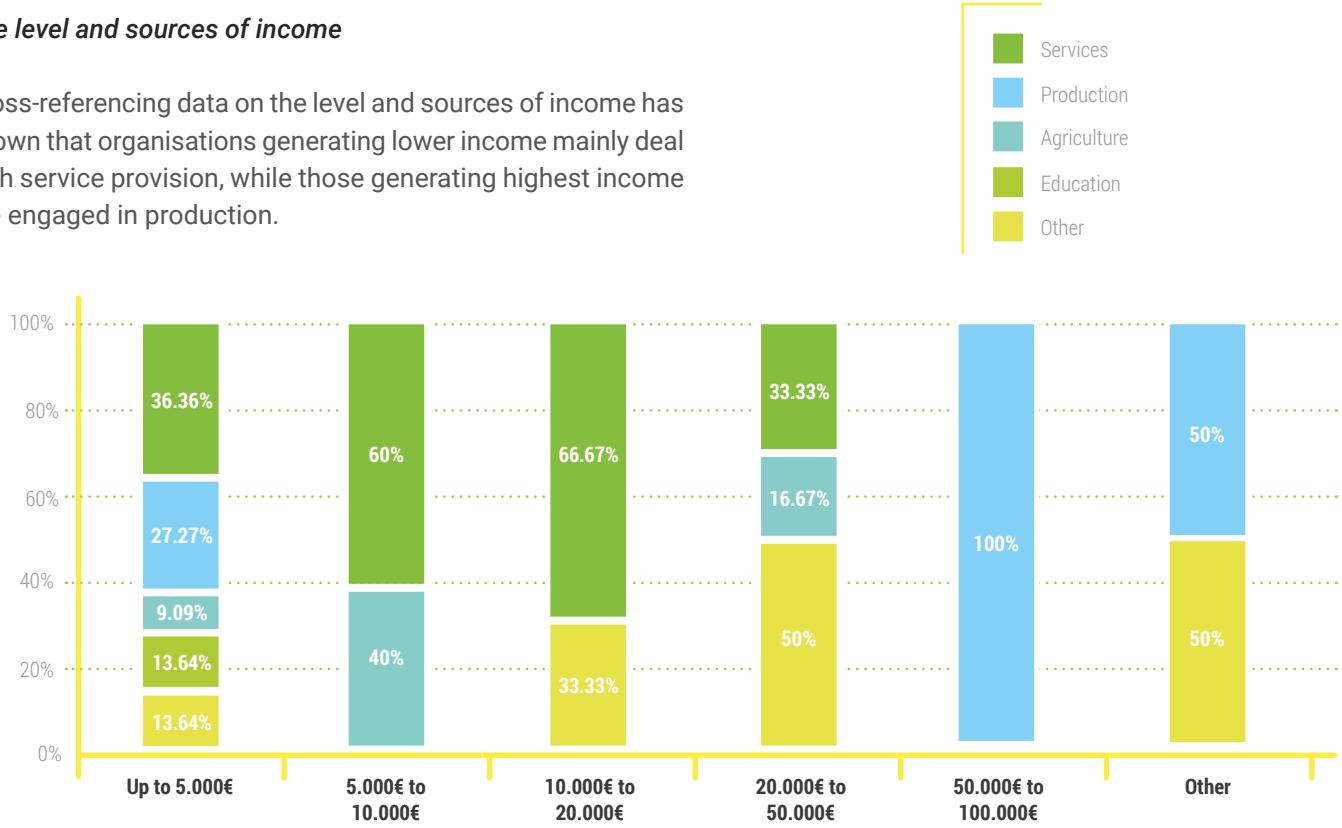
Sources of income

Majority of social enterprises generate income by service provision - 47.5% (social, heath care, tourism, culture, etc.). This is followed by production with 32.5%, agriculture with 12.5% and education with 7.5%.



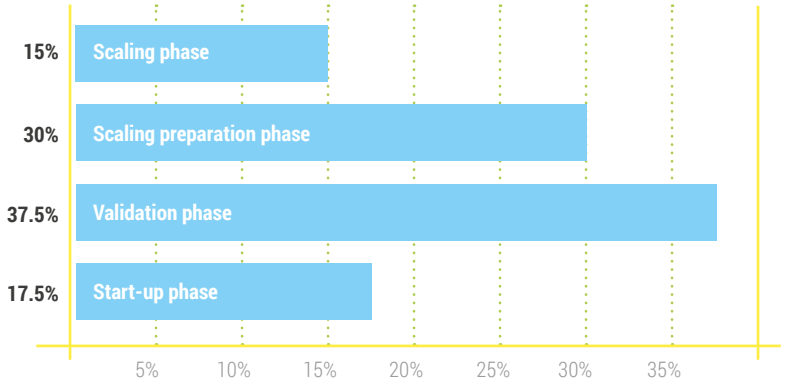
The level and sources of income

Cross-referencing data on the level and sources of income has shown that organisations generating lower income mainly deal with service provision, while those generating highest income are engaged in production.



Development phase

Many of the social enterprises consider themselves to be in the validation phase, namely 37.5% of them. This is followed by the scaling preparation phase reported by 30% of social enterprises. Start-up phase was identified by 17.5% of social enterprises, while 15% of respondents find themselves in the scaling stage.



Start-up phase (understanding consumer needs, business plan and initial consumer offer development, development of basic production technology and product prototype).

Validation phase (trial market entry and testing assumptions from the business plan, review of business plan, technology or product if needed).

Scaling/growth preparation phase (stimulating demand and raising consumer awareness about the product, supply chain development, purchase and processing of raw material, scaling capacity building: developing business system, human resources and production plants).

Scaling/growth phase (extension to new markets- introducing new products/services, conquering new markets with new products or new geographic markets, investing in human resources and assets, improving business system and production processes).

3. Business operations of social enterprises in 2016

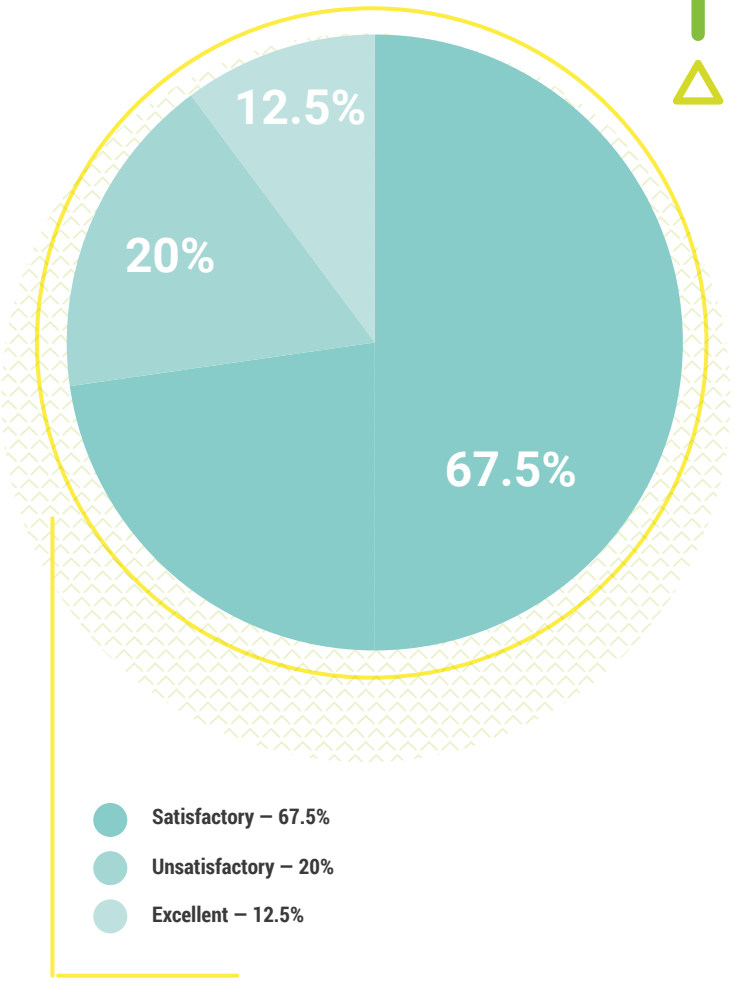
Business evaluation in 2016

The respondents were asked to evaluate their business in 2016. The largest number of organisations were satisfied with their business in the previous year, i.e. 67.5% of them. One fifth of organisations was not satisfied with their business in the previous year, while 12.5% of organisations evaluated their business in 2016 as excellent.

The main reasons underlying such **satisfaction** listed were the following: securing the market which can absorb the entire production, achieved increased income level compared to the previous year, sales network extension, employment of new staff, licensing of services, purchase of office space and equipment. In addition, a number of organisations have stated that their reason for satisfaction was survival in the current economic situation.

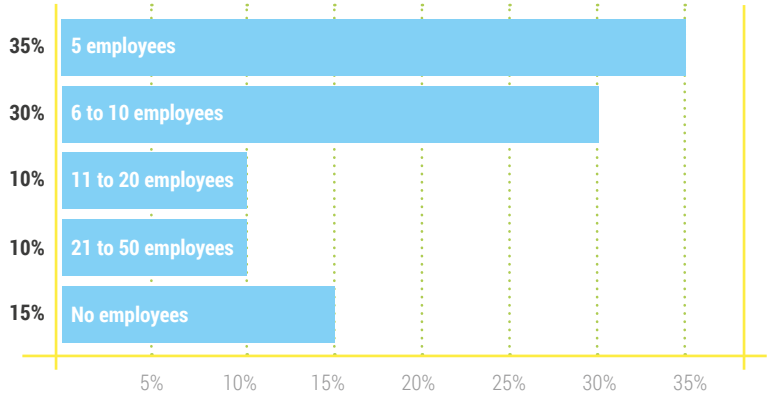
Among the **reasons for dissatisfaction**, highlighted were the lack of resources for implementation of plans, lack of support by the government and donors, too long a wait for operating permit to commission plants, insufficient income for sustainability and reduced sales.

In relation to business doing and functioning of organisations and social enterprises surveyed were the number of employees, their structure and total last year's budget.



Number of employees

The question on the staff number implied the employees based on the employment contract and non-employment contract (service contract, contract on occasional and temporary jobs, royalty contract, etc.). 35% of the sample have up to 5 employees, 30% from 6 to 10, 10% have 11 to 20 employees, 21 to 50 employees were reported by 10%, while 15% of social enterprises do not have employees and operate on voluntary basis exclusively.



Number of employees from vulnerable categories

Examining the number of employees from vulnerable categories also included the employed based on the employment contract and those based on the non-employment contract. The results have shown that 40% of respondents have up to 5 employees from vulnerable categories, 7% employ 6 to 10 persons, 8% employ 11 to 20 persons, and 3% employ 21 to 50 persons from vulnerable categories. The remaining 42% of social enterprises do not employ a single person from vulnerable categories.

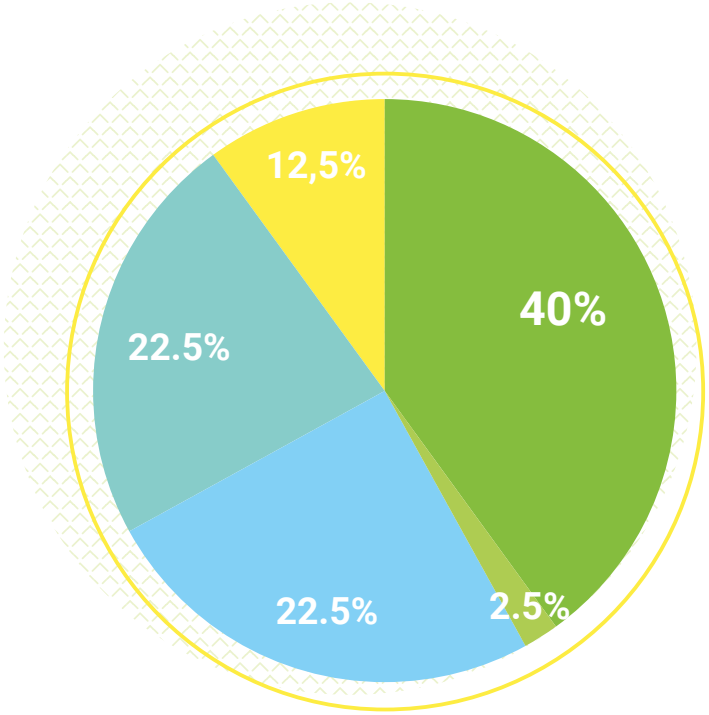
The number of volunteers

Given that in their work social enterprises rely extensively on volunteers, the research also looked at the number of volunteers included in various activities. In the surveyed sample, 10% of social enterprises do not have volunteers, 20% have up to 5 volunteers, 15% have 6 to 10 volunteers, 22% have 11 to 20, while 30% of organisations have over 20 volunteers.

Annual income of social enterprises in 2016

The surveyed enterprises provided information on their annual income level in 2016 (total value of assets from donations, membership fees, services, products and other inflows in 2016). The highest number - 40% of social enterprises, in 2016 generated income between EUR 10,000 and 50,000, while 22,5% of respondents generated income of up to EUR 10,000, or in the range from EUR 50,000 to 100,000. Lesser number of 13% generated income ranging from EUR 100,000 to 500,000, while 2,5% of social enterprises achieved annual income above EUR 500,000.

TOTAL BUDGET IN 2016



- 10.000 to 50.000 € – 40%
- 50 to 100.000 € – 22.5%
- Up to 10.000 € – 22.5%
- 100.000 to 500.000 € – 12.5%
- Over 500.000 € – 2,5%

Sources of income for social enterprises in 2016

Majority of social enterprises use the possibilities of hybrid financing, i.e. in their work they rely on multiple sources of income- income from donations (donations from public sector, domestic and international donors and foundations, donations and sponsorships from companies) and income from the sales and services. The analysis included the share of different sources of income in total annual income of social enterprises in 2016:

Amongst the surveyed social enterprises, 50% of social enterprises' income from donations accounted for more than 30% of total income, whereas in 30% of them income from donations comprised over 50% of total donations.

In the total sample, in 55% of social enterprises income from sales and services accounted for over 30% of total income, while in 35% this income represented over 50% of total income. Annual income from sales of products and services amounting to 100% was realised by 7.5%, i.e. 3 enterprises in the sample, while additional 7.5% generated over 90% of their income from sales.

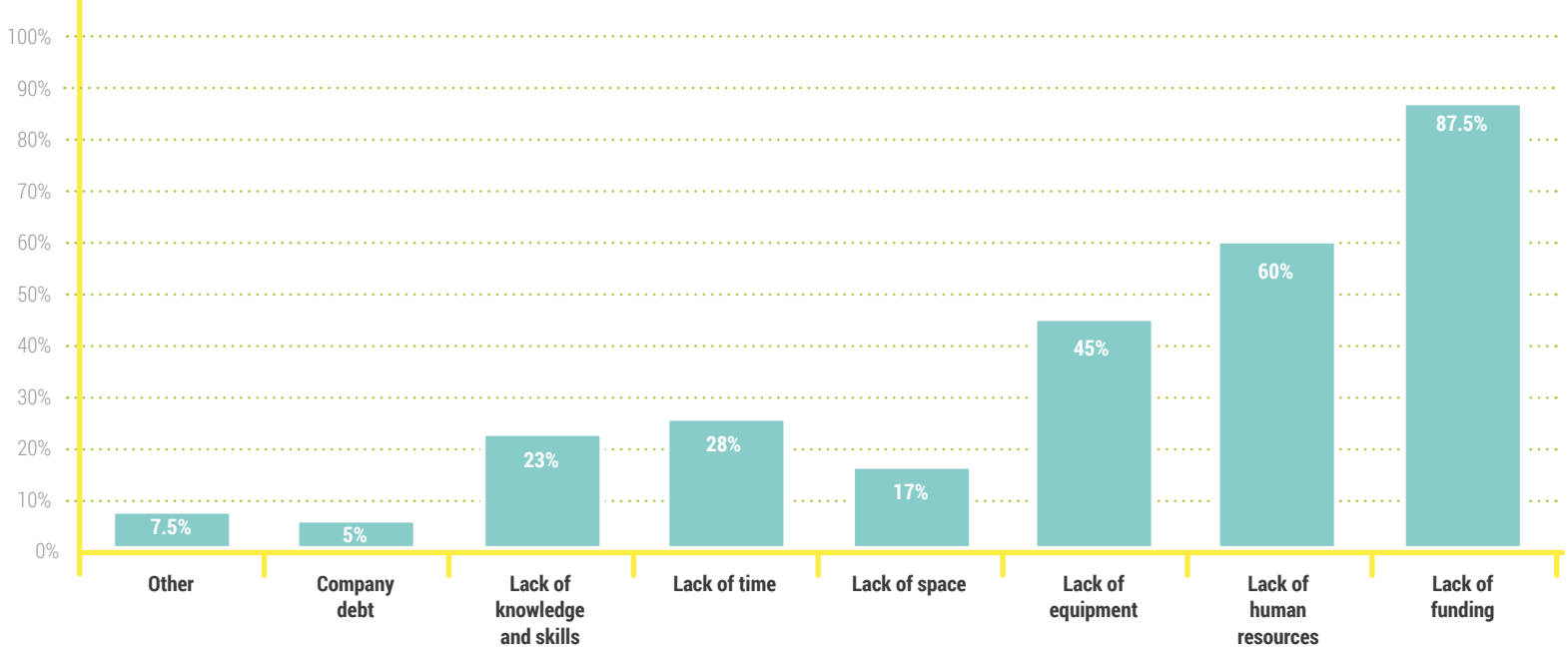
When it comes to the **sources of funding** in 2016, 65% of social enterprises used public sector grants, 55% grants of foreign donors and foundations, 52.5% grants of national donors and foundations, and 37.5% grants from companies. Income from membership fees was generated by 25% of social enterprises, income from sales of products and services 85% of them, while 15% generated income from provision of social services. The remaining sources of income pertained to loans, in 7.5% of respondents, and other in 7.5%.

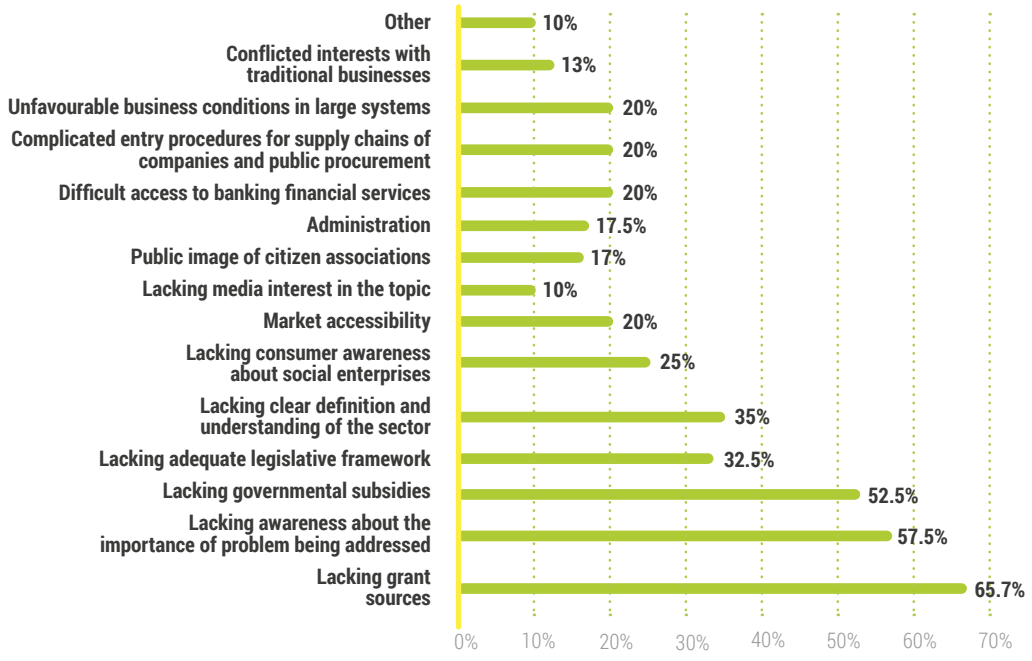
Challenges and needs of organisations

In examining challenges and needs, the research addressed the challenges faced by the social enterprises, both internally and externally, and the necessary forms of support and time frame in which they would require such support.

The most important problems and challenges in the operation of social enterprises

Talking about the most important problems and challenges in the work of social enterprises, according to the obtained results, a major problem is reflected in the lack of funding reported by 87.5% of social enterprises, followed by the lack of human resources with 60%, and lack of equipment with 45%. The lack of time makes a problem for 28% of respondents, lack of knowledge and skills for 23%, and lack of space for 17% of respondents in the sample. Social enterprises rarely have the problem of overindebtedness, and only 5% of respondents have stated this as a significant problem in the work of their organisation, which can be explained by the fact that until 2017, there were no borrowing services available in Serbia for citizen associations and social enterprises.



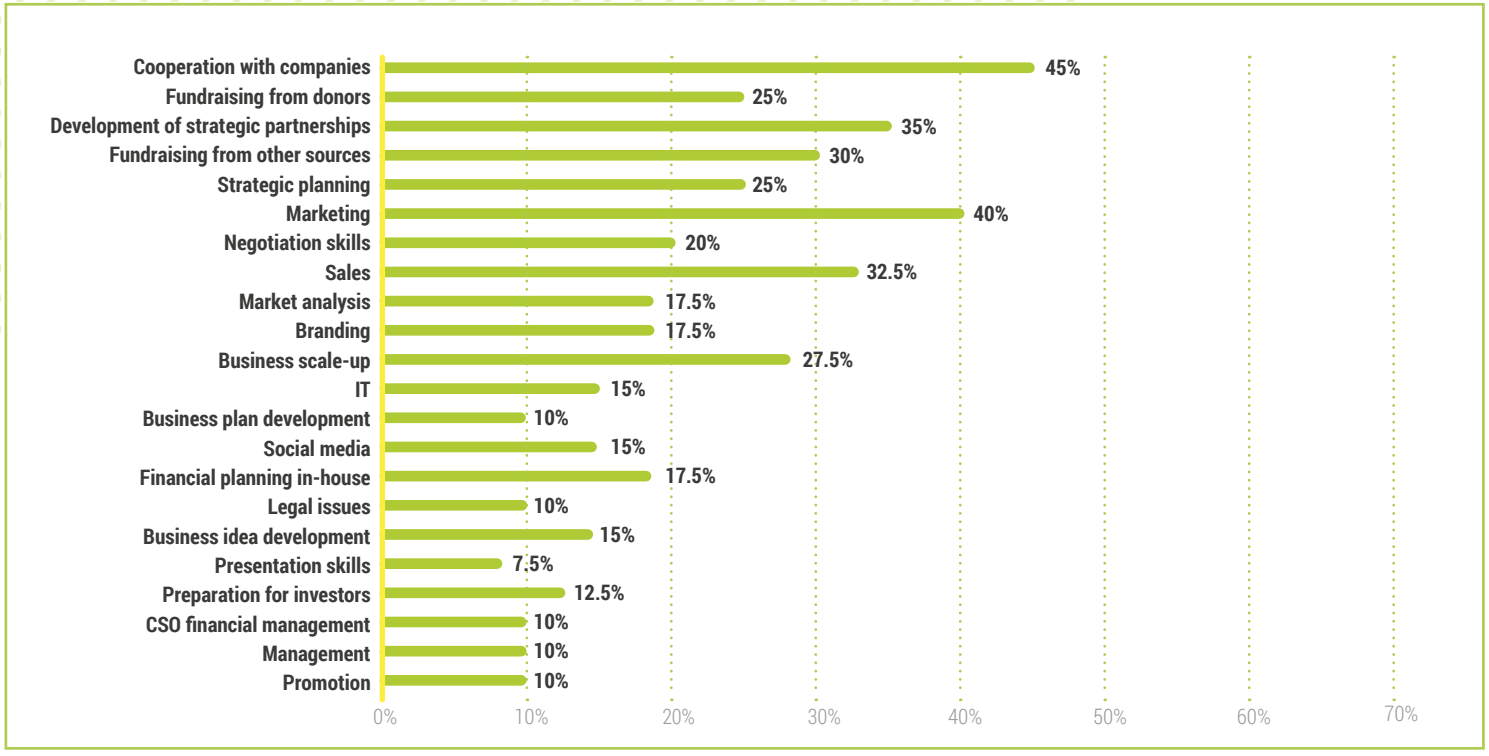


The most important problems and challenges in external environment

In terms of challenges in external environment, predominant is the lack of grant sources (65.7%), lack of public awareness on the relevance of the problem addressed by social enterprises (57.5%) and lack of governmental subsidies (53.5%). In addition, important barriers are reflected in the lack of a clear definition and understanding of the sector, same as the lack of the appropriate legislative framework, which was declared by 35%, i.e. 32.5% of social enterprises.

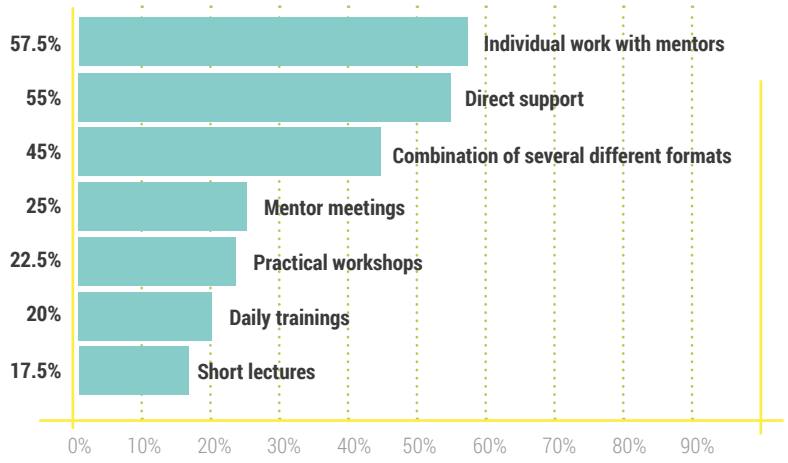
Knowledge and skills required for further development of social enterprises

In regard to the needed knowledge and skills, 45% of participating social enterprises have highlighted cooperation with companies. This is followed by marketing with 40%, development of strategic partnerships with 35%, sales with 33%, and fund raising from other sources with 30%. Likewise, a notable number of social enterprises require knowledge and skills in the area of business development (27.5%), strategic planning (25%), raising funds from donors (25%) and negotiating skills (20%).



Method of providing support

Social enterprises were offered to select multiple answers to the question referring to the forms of support contributing most to their further development. 57.5% of social enterprises in the sample selected individual work with mentors as the best method. This is followed by the need for direct support (promotion, sales, etc.) with 55% and combination of several different formats of support with 45%. Concerning other formats of support, 25% selected mentor meetings and group work, 22.5% practical workshops and exercises, 20% daily trainings, and 17.5% short lectures.

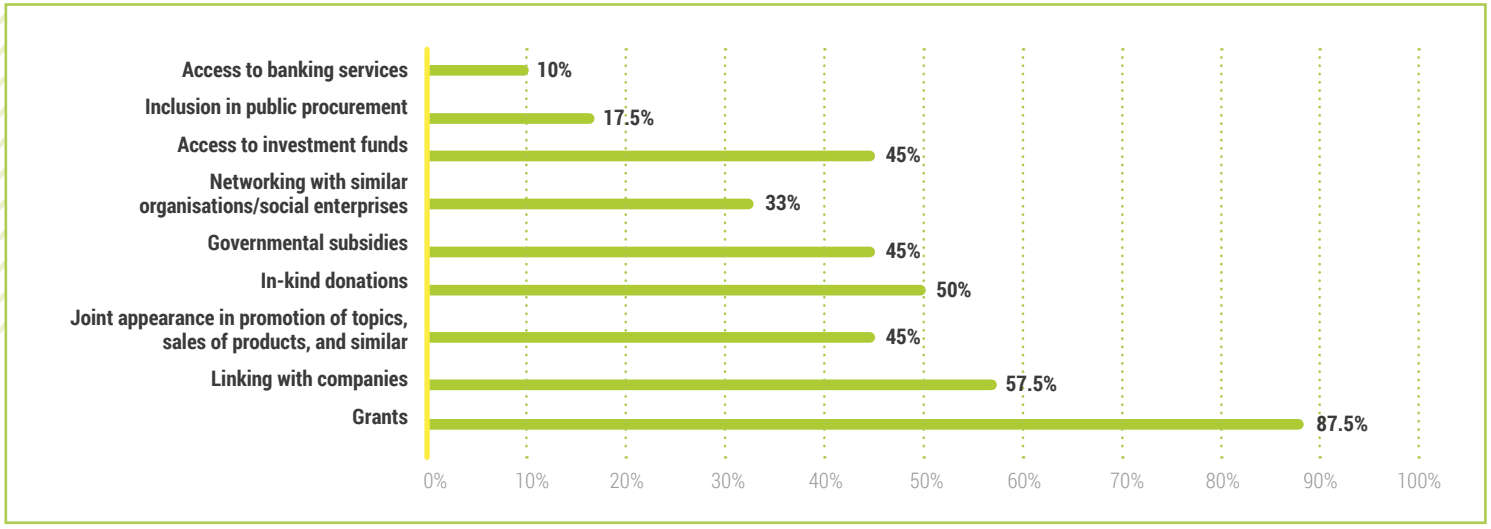


Time frame for provision of expert support

Majority of social enterprises participating in the research, namely 38% of respondents, consider they would need expert support during the period of 6 months, while 35% expressed the need for support in duration of six months to one year. In total 25% of social enterprises were of the opinion they needed longer support of between one and three years, and only 3% stated the need for support of three to five years.

Other types of support

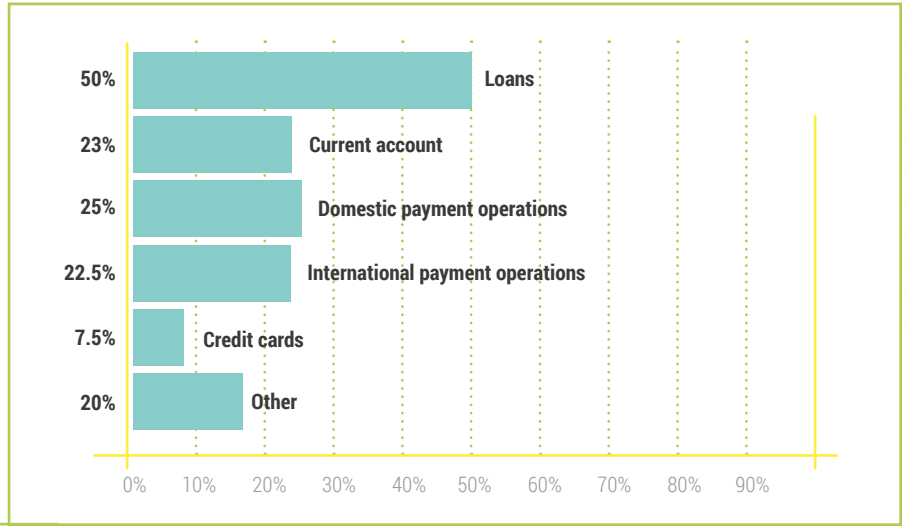
Regarding **other types of support**, largest number (87.5%) of social enterprises stated the need for grants. There was also a large need present concerning linking up with companies (57.5%) and donations in equipment and raw material (50%). Besides, a significant number of respondents highlighted the need for joint appearance in promotion and sales, governmental subsidies and access to investment funds (45% respectively). Networking with similar organisations and social enterprises was the need of 33% of respondents, inclusion in public procurement of 17.5%, while 10% of surveyed social enterprises stressed the need for access to financial banking services.



Banking services

In connection to banking services they were in need of, 50% of social enterprises said they needed loans. This is followed by domestic payment operations (25%), current account (23%), services of international payment operations (22.5%) and finally, credit cards (7.5%).[2]

2 – Other participants in the research responded they would need an unrestricted pay pal or more favourable package of banking services. Around 7% of respondents answered they didn't need the listed banking services.

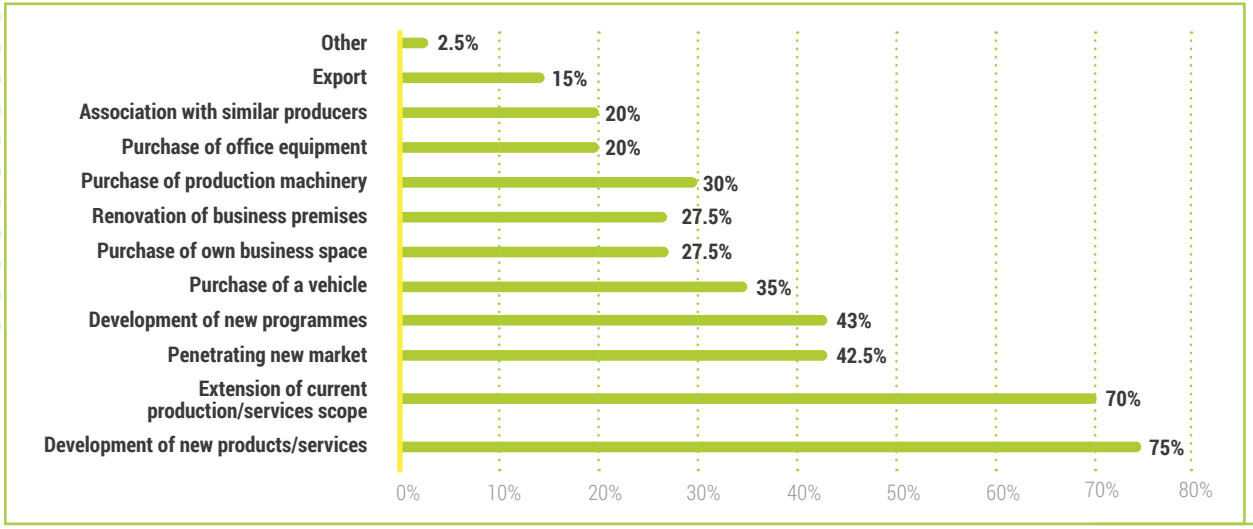


Development plans and needed funding

Concerning the development plans, social enterprises were asked if they had such plans and what they were focused on, how much money they would need to implement them, how would they invest it and if they would be willing to apply for loans with commercial banks and under which conditions.

Plans

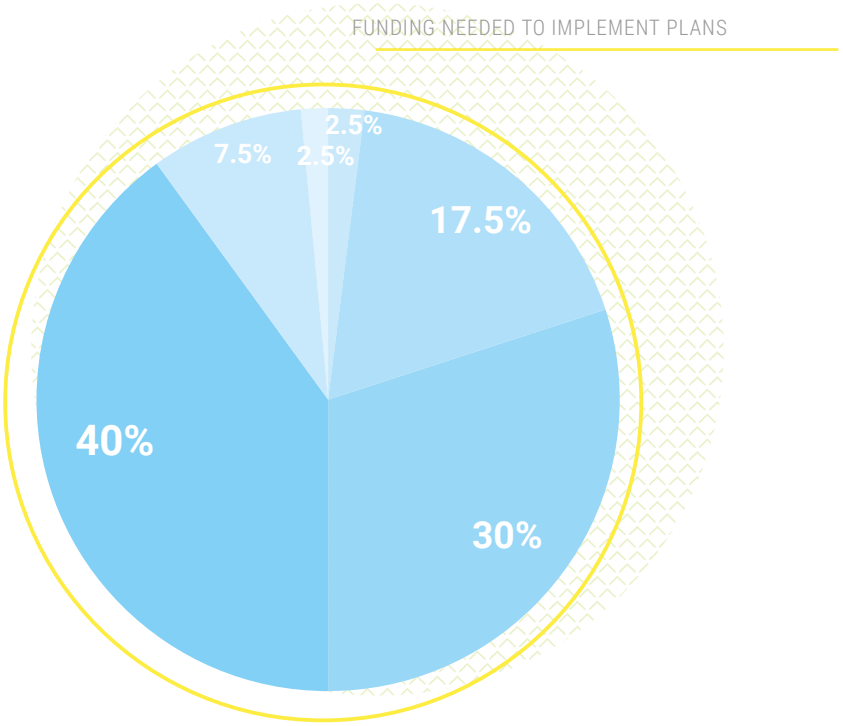
For a majority of respondents, plans for further development were connected with development of new products and services (75%) and extension of the existing scope of production or service (70%). Moreover, the focus of a significant number of social enterprises pertained to penetration to a new market (42.5%), development of new programmes (43%) and purchase of a vehicle (35%). Their priorities further include purchase of production machinery (30%), renovation of premises and purchase of their own business space (27.5% respectively). This is followed by purchase of office equipment and association with similar producers (20% respectively). Export was listed last with 15%.



PLANS FOR FURTHER DEVELOPMENT

The funds needed for implementation of plans

For the implementation of plans, a major number of social enterprises required the amount ranging from EUR 50,000 to 100,000 (40%) and from EUR 10,000 to 25,000 (30%). 7.5% of respondents in the sample stated the need for amount between EUR 5,000 and 10,000, and 17.5% for the amount ranging from EUR 25,000 to 50,000. The need for amounts exceeding EUR 100,000 for further development of a social enterprise and implementation of existing plans, was stated by only 2.5% of social enterprises.



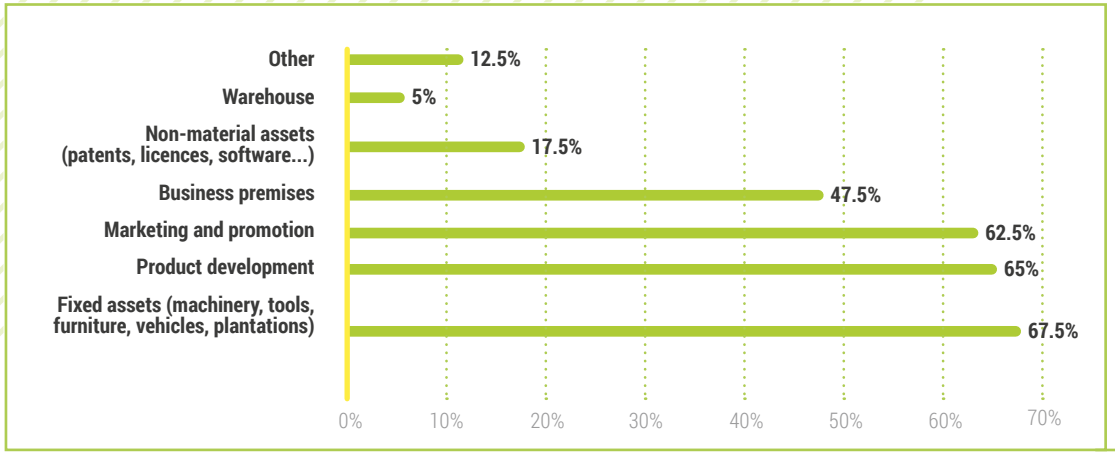
Development phase and needed funding

Enterprises in earlier development phases (start-up and validation phases) expectedly needed lesser amounts of money, namely mainly between EUR 5,000 and 10,000 and between EUR 10,000 and 25,000. Enterprises in further phases of development (preparation for growth and growth phases) needed larger amounts of money to implement their plans, mainly ranging from EUR 50,000 to 100,000 and over EUR 100,000.

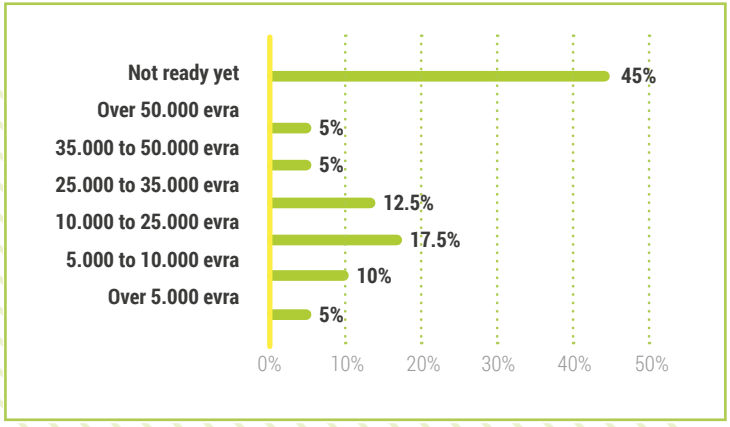
Investment method

70% of social enterprises would invest the required amount in fixed assets needed for their operation (machinery, tools, furniture, vehicles, plantations, etc.). Next on the priority list were product development (65%) and marketing and promotion (62.5%). Business premises were the next with 47.%% of social enterprises being willing to invest to that purpose. 17.5% of respondents would invest the required funds in non-material means such as patents, licenses and software, and only 5% in storage facilities.[3]

3 — The remaining 10% of respondents would invest funds in items not covered by the listed categories: new employment or without a clear idea.



INVESTMENT METHOD

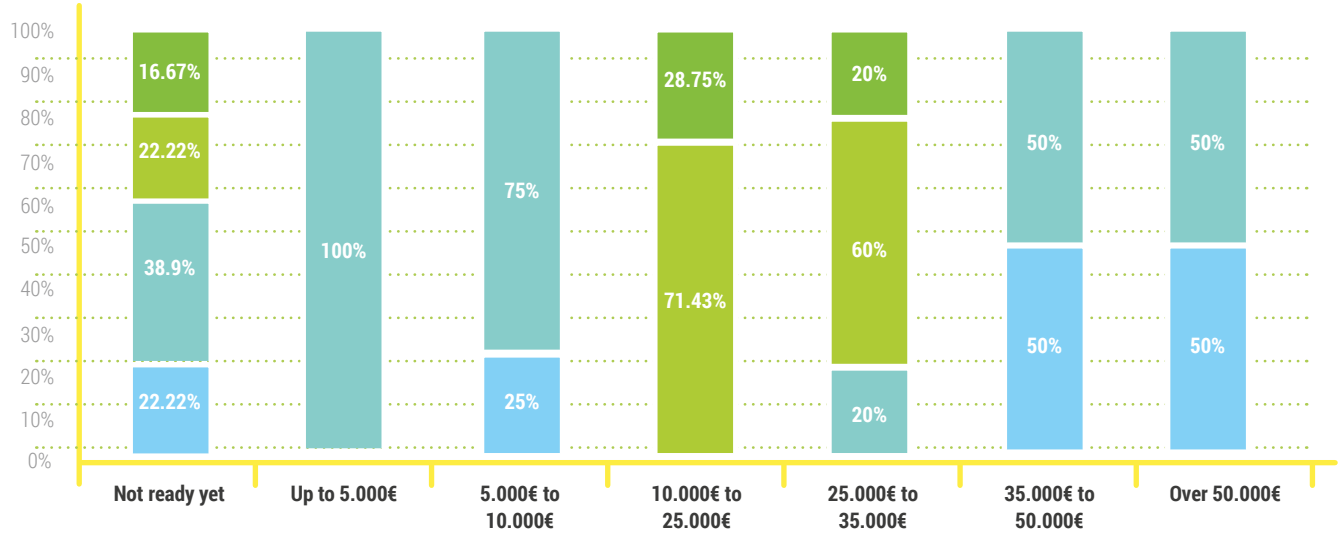


Securing funds by borrowing

Organisations were asked if they would be ready to secure the needed funds by borrowing (loan) and if yes, what would be the amount they would apply for. Out of the total number of respondents, 45% of social enterprises stated they were not ready to use borrowing. The largest number of respondents, 17.5% of social enterprises, would apply for the amount ranging from EUR 10,000 to 25,000, 12.5% for the amount between EUR 25,000 to 35,000, and 10% for the amount in the range between EUR 5,000 and 10,000. For the amount of up to EUR 5,000, same as for the funds ranging from EUR 35,000 to 50,000 and over EUR 50,000, 5% of social enterprises would apply respectively.

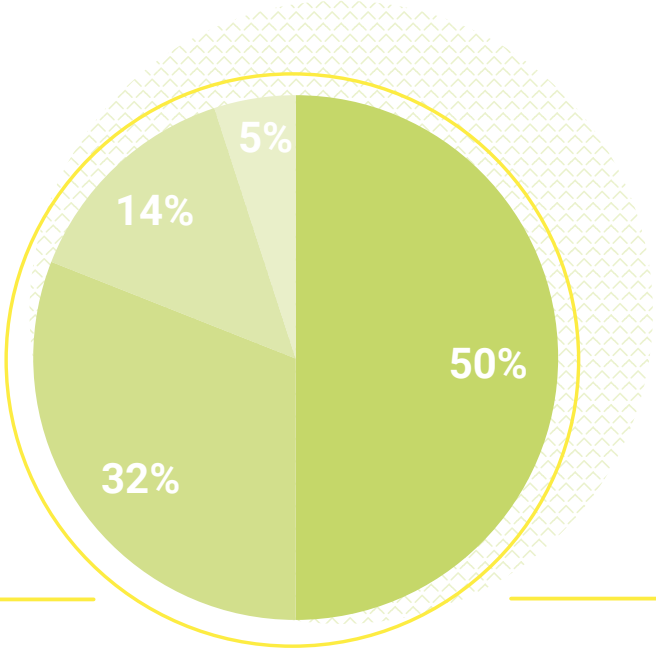
Readiness for borrowing and development phase

For the borrowing of EUR 5,000 interest was demonstrated by enterprises in the validation phase (100%), while for the loan amounting between EUR 5,000 and 10,000 enterprises in the validation phase (75%) and start-up phase (25%) would apply. Organisations in the phase of preparation for scaling or in the scaling/growth phase would mostly apply for amounts between EUR 10,000 and 25,000 and between EUR 25,000 and 35,000.

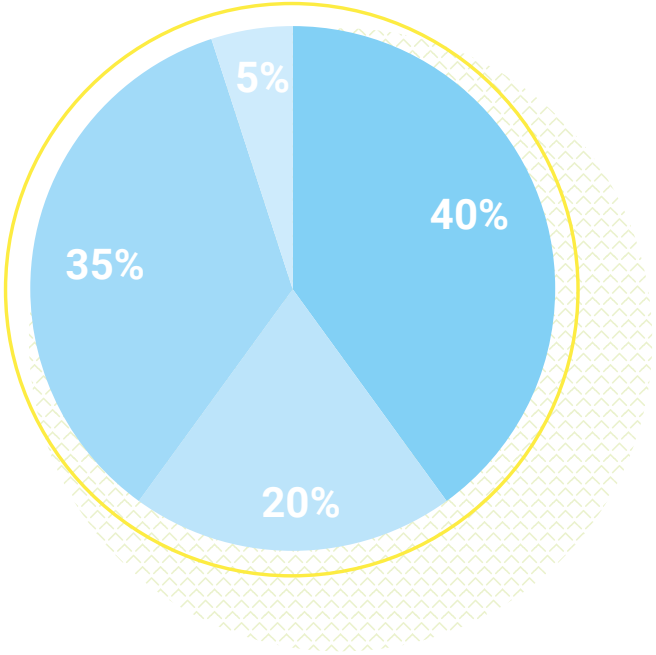


Monthly repayment

Majority of the social enterprises which declared they were willing to take up a loan would find a lower monthly repayment amount suitable. Half of them would find adequate a monthly repayment amounting to EUR 250, for 32% of them appropriate amount would be between EUR 250 and 500, while only 5% would take up a loan with the monthly repayment exceeding EUR 500.



- Up to 250 € – 50%
- 250 to 500 € – 32%
- Other – 14%
- Over 500 € – 5%



Collateral

Social enterprises were asked if they had collateral available, like equipment, vehicles, land and if they would be willing to pledge such collateral. 35% of respondents did have a collateral available, 20% of them did have them however they were not ready to pledge them, while 40% did not have the collateral in hand.

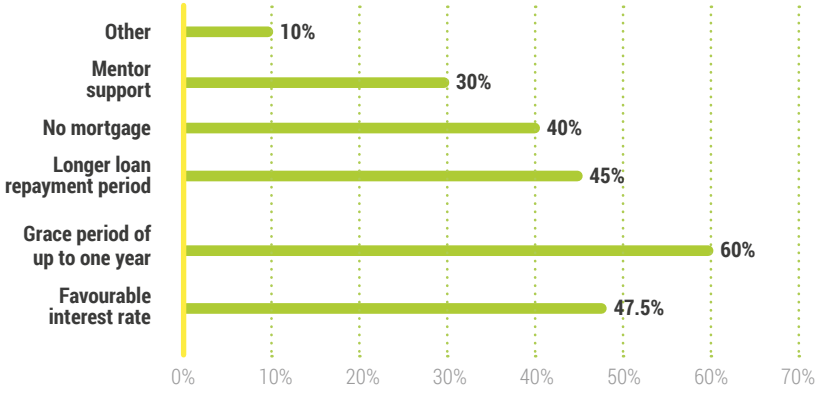
- No – 40%
- Yes – 35%
- Yes, but not willing to pledge – 20%
- Other – 5%

Credit support

When asked if they would find access to credit support useful, 70% of social enterprises responded positively, while 30% of them said they would not find access to credit support useful. Amongst the social enterprises which would find the access to credit support useful, majority (93%) preferred long-term loans (with repayment period of over 12 months), while only a small number reported the need for a short-term loan (with the payback period under 12 months), which was the case with only 7% of social enterprises in the sample.

Incentives and reliefs for borrowing

Respondents have answered the question on the type of bank incentives and reliefs they would find most useful to allow them to apply for a loan. For the majority of respondents these were grace period of up to one year (60%), favourable interest rate (47.5%), and longer loan repayment period (45%). This is followed by non-mortgage loans with 40% and mentoring support with 30%.



SOCIAL FINANCING INSTRUMENTS AND BEST PRACTICES

1. GRANTS

Definition of Grant

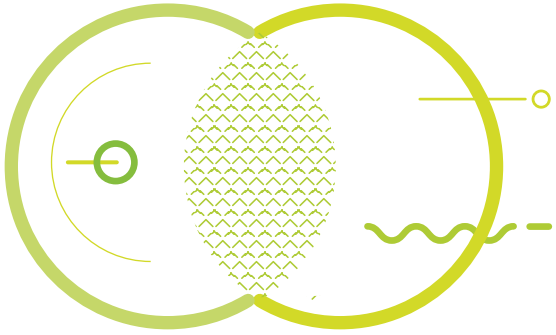
Grants represents the most traditional form of financing for socially oriented organizations. Despite all the limitations, grants from public sources and private foundations remain a key source of funding for social enterprises.

Challenges of grant funding

The recent financial crisis highlighted the unreliable nature of grants, as donors and public sources can choose not to donate during difficult times. Furthermore, the grant application process can represent a significant time drain on smaller organizations. Lastly, as many grants have certain requirements for their use, dependence on these grants can cause significant mission drift as organizations seek to satisfy the requests of the grantor.

Tools of grant funding

In an effort to make this funding instrument more reliable and available, certain organizations have pioneered the use of recoverable grants. These recoverable grants are, in time, repaid by the enterprise so that the money can be re-granted to another cause. In addition, this financial tool, structured as a grant and not a loan, enables organizations to bypass regulations around lending requirements.



NESsT Pioneers Recoverable Grants

In Romania, regulations limit lending practices to only licensed providers and banks. This has limited the venture philanthropy tools available to NGOs, incubators, and other foundations primarily to grant-making. In order to bypass this requirement, NESsT has pioneered the use of recoverable grants.

These grants have 0% interest (i.e. only the initial amount of money given is repaid). However, they are not repaid until after the recipient passes certain milestones regarding financial and social impact sustainability (i.e. positive cash flow, a given sales revenue, a certain number of people impacted). Then, the enterprise begins to pay back the loan. NESsT uses a system of tranches wherein different parts of the grant are repaid after different milestones are met. Although the money is repaid, these are structured as grants, as opposed to loans, from an accounting perspective.

Advantages and disadvantages of grant funding

GRANTS	PROS	CONS
Investors	High social return	100% risk Unless stated, no clawback if money not spent or misallocated
Entrepreneurs	No repayment	May have high fundraising and/or time costs Low entrepreneurial flexibility

2. EQUITY

Definition of equity

Provision of capital to a firm, invested directly or indirectly in return for total or partial ownership of that firm and where the equity investor may assume some management control of the firm and may share the firm's profits[1].

The Need for Equity Financing

Equity financing is an urgent need for social enterprises to provide start-up costs, as most cannot secure traditional loans without a prior track record. Furthermore, many social enterprises complain that debt seriously impedes their ability to make a social impact as it requires them to raise more profit, increase prices, and cuts service to the communities they hope to serve.

1 – "*Financial instruments working with social entrepreneurship*", 2016, European Commission and European Investment Bank, page 19

Tools within Equity Finance

There are numerous investment tools in the area of equity-based social investment. They have been developed for a variety of reasons such as creating larger, more scaled investment opportunities; connecting investors and enterprises; creating different risk-reward ratios; and bypassing regulatory requirements. While an investor could directly buy shares in a social enterprise, it is more common to invest through a fund. Furthermore, some investors/funds only invest in private enterprises, while others will invest in publicly-traded companies, or a combination thereof. Other innovations, such as pre-agreed share buy backs by the enterprise, are meant to minimize investor worries around liquidity and other investment qualities.

The equity-based fund represents the most basic financial investment opportunity. Examples include Ananda Social Venture Fund (Germany), Impact Ventures (UK), and Adva Healthcare Fund (Russia and former Soviet States).

Private Equity Funds in Eastern Europe: Small Enterprise Assistance Funds (SEAF)

SEAF operates numerous funds in the Balkan region, including one in Serbia, that look to invest in mid and large size communities that will have a wider communal impact. Frequently, they invest through equity and mezzanine financing. One of their noteworthy investments in On.Net of Macedonia lead to Macedonia becoming the first fully wireless internet covered country in the world. In particular, this investment was successful because they were able to help manage the company effectively. This lead to a successful exit when Slovenian Telecom bought SEAF's shares in the company. SEAF's success can largely be credited to their management and finance management assistance.

Source: Seaf.com/portfolio-item/on-net/

Fund-of-funds

To create an even larger investment opportunity, fund-of-funds (FoF) pool money to invest in a portfolio composed of other investment funds. This offers an opportunity to mitigate risk in 'solidarity funds' that hold a mixed proportion of conventional investments and impact investments.[2]

2 — http://www.eurosif.org/wp-content/uploads/2015/02/Impact-Investing-Extract.pdf

The Social Impact Accelerator (SIA), European Investment Fund

Many potential impact investors complain that finding investment opportunities with an appropriate scale and track record can be difficult. The fund-of-funds, an investment opportunity composed of a collection of funds, creates an opportunity for larger investments while spreading the risk.

The European Investment Fund, an EU agency responsible for financing small and medium sized businesses (SMEs), recently launched a fund-of-funds called the Social Impact Accelerator (SIA). The European Investment Fund (EIF) has secured the Bulgarian Development Bank (BDB) as additional investor for its Social Impact Accelerator Initiative (SIA). BDB has committed to invest EUR 1 million into the first pan-European public-private partnership supporting social enterprises. This investment contributes to diversifying SIA's source of funding, especially in Central and Eastern Europe, including Bulgaria, which is still a comparably young and undeveloped market for social enterprises and social funds.

Source: http://www.eif.org/what_we_do/equity/news/2015/bdb_sia.htm?lang=-en

Quasi-equity debt

Quasi-equity debt, or a **revenue participation investment**, represents an innovative tool that works to protect the social enterprise from exorbitant debt, while also helping bypass legal barriers to investors. In many nations, non-profit institutions, such as foundations, find it hard to invest in social causes as legal regulations prohibit them from obtaining equity in another organization. To bypass this legal requirement, quasi-equity debt is a financial instrument that acts like equity, but is legally debt. Essentially, an investor will give out a loan, but the return on the loan is based on the revenues of the enterprise. The return on investment is often capped at a certain amount or time period. This structure also benefits the social enterprise by lowering the risk of the social enterprise taking on debt it cannot handle. 1Furthermore, by taking the returns out of the enterprise's revenue (as opposed to profit), the enterprise has an extra incentive to operate cost-effectively. These structures give investors an investment option with only a moderate amount of risk.

Gazelle Fund

Gazelle Fund hopes to raise a sum of $70m to invest primarily in agribusiness in Georgia, Armenia, Moldova, and Kyrgyzstan. To establish credibility, they raised the first $26m from reputable development banks, before pursuing donations from other institutions or individuals. That said, the fund notes that it also hopes to receive investments via the Overseas Private Investment Corporation, a US government program that coordinates private sources to invest overseas. They aim to target a subset of SMEs known as Gazelles ("fast growing SMEs") that currently have revenues of at least $200,000. In addition to their financing, Gazelle promises to supply technical assistance worth $10,000-$50,000 in training and assistance to its investees. Financially, Gazelle wants to use a number of financial instruments to mitigate risk including revenue participation loans (loans that are paid back as a share of revenues) and pre-agreed company buybacks of their equity. This means that Gazelle has worries about not being able to sell the shares and exit, so their investees agree to buyback the shares at a certain time/price.

Source: Impact Base Fund Prospectus

Depository receipts

Depository receipts are issued in order to protect a social enterprise from being driven off-mission by a profit-motivated investor. These receipts correspond to shares in an enterprise, but the actual shares are held by a trust-worthy and responsible entity, such as social bank Triodos, profiled below.

Triodos Bank

Triodos Bank has decided not to list itself on a public stock market "because if we were primarily accountable for delivering profit . . . we could not pursue our mission." That said, to offer investors an opportunity to support Triodos, they issue depository receipts that correspond to equity in the company. Holders of a depository receipt are entitled to profits from Triodos in the form of dividends and share price changes. In this way, Triodos Bank has taken away investors' voting rights to preserve their social mission. This enables Triodos Bank, which maintains numerous funds in such areas as inclusive finance, sustainability, and culture, to invest in a way that balances their social and financial return objectives.

Source: https://www.ethex.org.uk/triodos-bank-depository-receipts_426.html

State of the Equity Impact Investment Sector in Central and Eastern Europe

The existence of impact investment opportunities in Eastern Europe as a whole is low. Many of the funds come as a result of public-private partnerships such as the EU's Social Impact Accelerator, profiled above. That said, examples of primarily and fully private investment funds do exist in the region. While pursuing mostly private donations, these funds will sometimes try to get initial equity commitments from public entities such as development banks to gain some credibility. Furthermore, they often aim to attract investment from private foreign investors in the West. These funds target a range of industries and business sizes.

EQUITY	PROS	CONS
Investors	Close to market-competitive returns Social impact oriented	Fewer funds with track record Fewer funds with given characteristics (liquidity, etc.) Generally riskier investment Dependent on exit opportunity
Enterprises	Removes risk of debt Don't need assets to secure debt (no collateral) Investors often bring expertise Don't need track record to receive investment (as opposed to application for a loan) Investor is invested in business's success No cash flow requirements	Loss of control to investors Difficult to receive exposure to investors without help of a fund or intermediary Loss of profits to investors Can impact enterprise culture Not available for non-profits

Investor Considerations

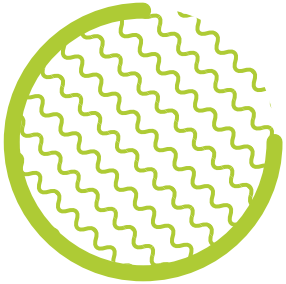
A chief concern of equity investors in privately traded social enterprises revolves around the liquidity of the investment, or how quickly an investor could convert his equity shares into cash when he is prepared to exit the investment. As there are not a huge number of impact investors in small and mid size enterprises, a number of financial instruments have been created which ensure the investor can sell his shares or earn his investment back even when there is not a strong market for social enterprise equity.

Social Enterprise Considerations

As an enterprise, using equity-based financing frees a young business from debt, which can slow its growth. Furthermore, debt can force a social enterprise to sacrifice its goals by forcing higher pricing or other changes that distort the mission.

A potential disadvantage, depending on the structure of the equity, can arise if investors have decision-making power in the enterprise. In typical equity structures, owning equity in an organization entails certain privileges, such as voting rights. Obviously, the potential for a conflict of interest arises if a profit-focused investor can guide a social enterprises's activities. The social goals of social enterprises can come into conflict with the financial goals of investors. For this reason, different equity-financing structures have been implemented that limit shareholders' powers (liquidation (end of company) rights; dividend/income rights, appreciation value; voting rights; transfer rights etc.).

3. Debt



Definition of Debt

Agreement which obliges the lender to make available to the borrower an agreed sum of money for an agreed period of time and under which the borrower is obliged to repay that amount within the agreed time.[5]

5 – "Financial instruments working with social entrepreneurship", 2016, European Commission and European Investment Bank, page 17

The Need for Debt

Debt finance offers an alternative to social enterprises that dislike the shared equity (and shared control) aspect of equity finance mechanisms. Broadly, debt financing refers to borrowing money that the borrower must then return with interest. It is best for businesses that have a stable business model enabling them to pay back the debt in a timely fashion.

Tools of debt financing

Debt financing is mainly composed of secured and unsecured loans and bonds. **Secured loans** require collateral while unsecured loans do not. **Bonds** differ from loans in that a bond is borrowing money from the public rather than a financial institution and the principal is paid off at the end, not overtime. Many financial instruments adapting these typical structures have been created to make the loans more appropriate for social and entrepreneurial enterprises.

- **Soft loans,** or concessional loans, can be designed with favorable terms to benefit the borrower including below-market interest rates, long repayment periods, or interest holidays (unpaid interest is added to the principal).

- **Convertible debt** is an agreement where an enterprise borrows money from an investor, and the debt is converted into equity (rather than being paid off) at a later date. An enterprise may prefer this to simply issuing equity if it believes its equity will be worth more in the future, and so taking convertible debt will dilute the shares the investor receives.

- **Guarantees,** and stand-by letters of credit, represent a way for donors and investors to leverage their impact by guaranteeing a loan from a bank or microcredit institution. Here, the investor guarantees any losses thus enabling social enterprises to obtain loans that would not be open to them in other cases.

- **Forgivable loans** offer a half-way between a loan and a grant. Here, the investor "forgives" the loan if certain conditions are met. For instance, if the enterprise reaches certain impact measurements, then the loan may be forgiven.

- **Demand Dividends** are loans that are repaid based as a percentage of the enterprise's free cash flow until a certain cap on the return is reached. They include a "honeymoon period" where the investee does not have to pay back the investment and can use the capital to grow the business. They represent a fairly low-risk tool for both the investor and the investee, although they can have a lengthier time horizon.

- **Sub loans.** Many larger organizations of both public and private investors have the resources to invest in social impact through debt, but believe that the actual investee identification, screening, and due process can be better accomplished by local organizations. These capital-heavy organizations provide loans to local microfinance institutions or community banks. Then, the community institutions use this funding to grant sub-loans to beneficiaries and social enterprises in their localities.

TISE: Impact Investing Through Concessional Loans in Poland

Since 2008, TISE manages two funds funding a collection of NGOs, and social micro and SMEs. The one fund is composed of TISE's 5m source of capital, while the National Economy Bank provides public support to the other fund. With over, 25m Polish zloty (5.7m Euros), this second fund can support a host of microbusinesses in various industries including labor cooperatives, cooperatives of the disabled and blind, social cooperatives, and non-profit companies.

Source: https://tise.pl/social-and-economic-investment-company-tise-sa/

Two Sub-Loan Agencies in Eastern Europe

COOPEST: Loans for Businesses Supporting SMES in CEE

Founded by a combination of banking, social finance, mutual insurance, and other financial organizations, Coopest provides medium-and-long-term loans and quasi-equity to social enterprise oriented financial intermediaries throughout Central and Eastern Europe. Now with a portfolio of EUR 32,346,000, Coopest supplies loans to microfinance institutions (MFIs), community banks, microfinance banks, mutuals and credit unions. In turn these organizations provide loans directly to SMEs in their region and areas of expertise. The average loan to a SME is under EUR 4,000. TISE, a social investment organization profiled above, performs all the due diligence on Coopest's investments. In terms of impact, Coopest's partners record economic, social, and environmental impact metrics and Coopest estimates that it has helped to create 15,000 jobs and maintain another 100,000. A whole 6% of Coopest's portfolio is invested in Opportunity Bank Serbia, a microfinance bank based in Novi Sad.

Source: http://www.coopest.eu/web/

European Fund For Southeast Europe (EFSE): A Public-Private Partnership

The result of donations from both private institutional investors as well as public development organizations, EFSE donates its funds to support SME development, provide decent shelter for all, and strengthen local financial markets. The EFSE uses its immense portfolio of EUR 2 billion to provide loans to over 70 community banks, microfinance organizations, and other impact investment funds. Using the full range of debt financing – including long-term loans, subordinated loans, guarantees, and buying bond issues – the EFSE endeavors to promote a variety of financial tools. All sub-loans given out by the community financial intermediaries must remain under EUR 100,000, with a priority on loans under EUR 20,000. In addition, the EFSE provides technical training to its partner intermediaries. Within Serbia, the fund has 7 partner institutions including microfinance banks and regular commercial banks.

Source: http://www.efse.lu/

Advantages and Disadvantages of Debt Financing

DEBT	PROS	CONS
Investor	Lower risk More regular returns Debtors get money first upon liquidation	1) Smaller upside compared to equity 2) Can have long time horizons
Entrepreneur	Retain control Debt is cheaper than equity	Need established business model Impacts cash flow Need collateral

4. Microfinance

Intersection between Microfinance and Impact Investment

Microfinance is a concept which exists for decades and which, for many years, provided banking services to low-income people to enable them to become self-sufficient through access to borrowing money, saving money, and insurance. Unlike microfinance, Impact investing emerged recently and it provides a broader range of support and business building beyond just banking services. As microfinance has become more mainstream, the intersection between microfinance and impact investing has become more aligned through shared social motivations.[6]

Definition of Microfinance

Microfinance offers people usually excluded from existing and formal financial resources and banking the opportunity to access small-scale financial tools.

Investors: Those offering microfinance services include microfinance institutions (MFIs), non-profit groups, community banks, as well as commercial banks.[7]

Recipients: Generally, microfinance helps those who cannot access the traditional banking system due to social and financial exclusion including: the elderly, women, migrants, and young people.

6 – http://www.aboutmicrofinance.com/impact-investing-overview
7 – http://www.european-microfinance.org/index.php?rub=microfinance-in-europe&pg=microfinance-by-country&cpg=39

Tools of microfinance

In the context of social enterprises, main tool of microfinance generally refers to microcredit. Beside microcredit, limited experimentation has started to show the validity of micro-equity as a business financing tool as well.[8]

- **Microcredit** is the main microfinance instrument. In the EU, microcredits are loans less than EUR 25,000. The average microloan in the EU is around EUR 7,000–7,500. In Serbia, the average microloan is EUR 1,200 to 1,500.
- **Micro-equity -** Critics of microloans insist that paying off debt precludes small businesses from truly growing and scaling. With high interest rates, critics argue that interest payments keep microbusinesses from being able to reinvest and use the loans to grow their business and become more independent. Many of these individuals believe that micro-equity has the potential to provide larger sums of capital to social enterprises while relieving the burden of debt. That said, modifications on the traditional equity arrangement are needed to protect both the enterprise as well as the investor. To protect the investor and mitigate risk, investments can be sold in tranches (this defines which shares are paid first if the business defaults) and shares can be tied to machines and equipment as collateral. To protect the micro enterprise and its social aims, investors should not be allowed to own a large stake in the company, and the micro-entrepreneur should retain the right to buy back shares at a fair price if the company is being liquidated.[9]

8 — Ibid
9 — http://voices.mckinseyonsociety.com/the-case-for-micro-equity/

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Microfinance Banks

Within Europe: Bank of Valletta (Malta)

In 2010, the Bank of Valletta opened the Joint European Resources for Micro to Medium Enterprises (JERMIE) with funding assistance from the European Regional Development Fund. This includes a collection of microenterprise financing tools, including microcredit. A secondary program of the bank benefited from an EIF program that provides guarantees on microloans, thus removing much risk from the equation. In any case, the bank has committed 61.8m euros to assist 650 SMEs resulting in income generation of a total of 103m euros today. In regards to just microenterprises, the bank has committed 1.5m to 90 enterprises, an investment currently worth 3m. These numbers do not have much of an impact on the bank's overall profitability currently, as they are relatively small.

That said, the bank has said they expect to receive a host of new clients in their traditional banking services as these businesses grow and develop. That said, the bank notes that in especially small markets such as Malta, the potential of microenterprises remains small. They recommend that microenterprise funding be part of a larger program to fund SMEs as well in these small markets.

Commercial Banks

Although commercial banks often show reluctance to enter microfinance due to screening costs, regularity barriers such as high mandatory provisioning (i.e. setting aside funds in case of defaults by the borrower), and knowledge barriers, some commercial banks in Western Europe have begun to offer various microfinance services. That said, commercial banks possess huge potential to boost microfinance due to their experience, access to capital, and established presence. Foremost, a bank's experience in lending and working with borrowers will help micro lenders adopt financially stable habits. Additionally, banks' access to capital will provide a much more dependable and scalable source of funding for social enterprises then current MFIs. Furthermore, commercial banks' increased reach and physical infrastructure will help with providing access and awareness of these microfinance tools. Unfortunately, few examples in Europe of commercial banks offering micro-finance products exist outside of Erste bank in Austria and Serbia (see section: *Financial instruments for social enterprises in Serbia*)

Erste Bank is a pioneer of micro-credit and social banking in Serbia and Central Eastern Europe

Erste Bank Serbia and the European Investment Fund (EIF) signed a guarantee agreement in 2016 with the aim of supporting micro-enterprises in Serbia within the EU Employment and Social Innovation Program (EaSI). The contract will cover a credit portfolio of 4.7 million euros for approximately 850 Serbian micro-enterprises, which will be able to benefit from loans under attractive conditions, without providing additional guarantees. This is the first step in the implementation of the "Step by Step" Social Banking Program in Serbia, which Erste Group launched in Central and Eastern Europe (CEE) and Austria, to support clients traditionally insufficiently involved in banking services: new businesses, including beginners in entrepreneurship, social enterprises, civil society organizations, and persons at risk of poverty. Expansion of the program on all seven main markets of Erste Group will be completed by 2019. The program aims to help 5,000 new jobs to be opened by 2019, provide financing for 500 social enterprises and improve financial stability of 25,000 people who previously had low incomes.

Source: https://www.erstebank.rs/sr/o-nama/press/saopstenja/2016/11/22/korak-po-korak

Non-Bank MFIs that have partnered with banks

Banks can benefit from these partnerships with MFIs through reaching a new segment of clients; CSR benefits; cross-selling of their own products; and conversion of MFI customers.[10] That said, in developing markets, banks and MFIs often have a more competitive relationship.

Two Case Studies of MFI Partnership with Banks

Action Finance Initiative – Greece

Greece's first microfinance institution (MFI) has figured out ways to get around a tough regulatory environment to provide loans and business training to those facing economic exclusion. As in Serbia, non-bank MFIs in Serbia are not legally allowed to provide loans, demanding MFIs to partner with willing banks to provide this service. In order to find a bank willing to partner, AFI performs much of the due diligence on behalf of the bank. AFI screens potential clients, provides business training pre and post loan, evaluates applications, and then forwards the applications to the bank for a second approval. Once approved, the bank remains responsible for tracking the borrower's performance. The bank provides the actual loan, but the collateral is supplied by the AFI with assistance from the EIF. Furthermore, the bank gets to keep the interest revenue while allowing the MFI to absorb the costs of initial screening. To cover their own expenses, AFI engages in partnerships with private investors. Still, the extra bureaucracy of working through a bank as an intermediary has added operational costs for AFI. To date, their portfolio consists of 18 loans.

10 – http://www.european-microfinance.org/docs/emn_publications/emn_research_papers/research_3.pdf

A Non-Bank MFI: Good.Bee Credit in Romania

good.bee Credit *(www.goodbee.com) is the non-banking finance institution (NFI) and financial inclusion tool of the Erste Group and the ERSTE Foundation . Founded in 2009, its main task is to develop innovative solutions that break the financial inclusion barriers for individuals and small enterprises from Romania, by expanding adequate and competent financial services to social enterprises and disadvantaged individuals. good.bee Credit clients are farmers, self-employed persons, individual and family enterprises, but also limited liability companies This category of clients is considered non-bankable, as they cannot meet the standard bank loan conditions. Throughout the almost 200 years of existence, the* ***Erste Group*** *has constantly maintained a significant social component in its activities. The simple fact that the largest shareholder within the Erste Group was and continues to be* ***ERSTE Foundation*** *proves that this character is being preserved.*

good.bee Credit *targets especially small entrepreneurs skilled householders in rural and small urban areas that wish to develop their income-generating economic activities. They need quick and easy access to financing, adapted to the economic conditions in their field of activity and environment. These are the reasons for which it is required to constantly adjust activities to their clients' needs, along these lines: simpler loan-accessing documentation, promptness in receiving the financing request and drafting the loan file, quick analysing of the request notifications regarding the financing or rejection decision, flexible repayment schedule according to the activity carried out by the entrepreneur client (in what concerns the level of instalments and the grace period), mixed material guarantees accepted depending on the required amount and period.*

http://www.goodbeecredit.ro/index.php/en/about-us/mission-and-objectives.html

Deutsches Mikrofinanzinstitut (DMI) – Germany

The DMI (an association composed of MFIS, banks, research institutes, and NGOS) has developed a more complex, although potentially more sustainable, partnership model to overcome the lack of regulation around MFI lending. This partnership has four main participants: banks, MFIS, guarantee funds supported by public and social investors, and DMI (in a supervising, quality assurance role). In Germany, banks remain too conservative to provide loans to new businesses without collateral or a track record. To combat this, MFIs provide the loan processing and due diligence, and the guarantee funds provide collateral to back the loan. In turn for providing the loan, the bank receives a portion of the interest rate (typically a rate of 8.95 APR) as well as the CSR branding benefits. In turn, the MFIs are able to circumvent the lack of regulation, as well as allow the bank to take care of loan administration, legal, and data security costs. In this way, the MFI can offer underserved populations favorable terms such as a holistic loan application, alternative guarantees, and training. A large number of the DMI's clients are women, migrants, or unemployed and enjoy an average loan of EUR 7.100.

Advantages and disadvantages of Microcredit

MICROFINANCE	PROS	CONS
Investor	1. Safe investment 2. High interest rates 3. High return rates	1.Not liquid, often long-term 2. Often underregulated 3. Fewer impact measurement tools
Entrepreneur	1. Access to capital 2. Often receive non-financial support 3. Maintain ownership	1. High interest rates 2. Debt inhibits growth 3. Mission drift due to debt Investor not invested in enterprise's success

5. Alternative Financial Instruments in Impact Investing

Social Impact Bonds (SIBs)

SIBs represent an innovative idea kickstarted by the City of London in 2010. A SIB exists as a contract between an investor, the government, and a social enterprise. In short, the investor invests funds in a social enterprise to address a social problem. Once the enterprise shows measurable success in tackling the issue (and thus saving the government money), the government pays an agreed amount back to the investors[11]. From a political perspective, this scheme shifts any potential losses and risks from taxpayer funds to the investor. Often, an intermediary organizes this arrangement between the public authority, investors, and the social enterprise. Furthermore, an objective third-party is often hired to verify results. In terms of risk to investors, SIBs are considered fairly high-risk, similar to equity investments. These have recently been adopted in Germany, Belgium and the Netherlands as well.[12]

11 — Third Sector Performance: Management and Finance in Not-for-profit and Social enterprise
12 — http://www.eurosif.org/wp-content/uploads/2015/02/Impact-Investing-Extract.pdf

Kois Investments Brings SIBs to Belgium

In 2014, Kois Investments, an impact investment firm, set out to structure a Social Impact Bond (SIB) to help relieve unemployment among Belgium's immigrant population. To accomplish this, Kois partnered with a Brussels-based NGO called DUO for a JOB that matches unemployed immigrant youth with networking mentors for six months to help find employment. Kois then approached Actiris, the Brussels Employment Agency, to act as the public partner in this SIB. Then, Kois Investments sold bonds to investors worth a total of EUR 234,000, promising a 6% return if successful. Of the 180 individuals in the program, the SIB proposed a concrete goal for 35% more of individuals to find employment over a 2-year span compared to a control

group. If accomplished, Actiris would be liable to pay the agreed upon amount at the expiration of the bond after three years. Kois lead the effort to find a social partner, recruit a public partner, and market the bond to investors.

The state estimates that they save EUR 35,000 per new employment. So, if DUO finds employment for 35% of the cohort, 63 individuals, this will result in savings of EUR 2,205,000, over 8 times greater than the investment cost. The results of this program will be released in 2016.

Source: https://data.gov.uk/sib_knowledge_box/brussels-migrant-uemployment https://www.conference-board.org/retrievefile.cfm?filename=TCB-GT-V1N13-Social-Impact-Bonds1.pdf&type=subsite

Hybrid Capital

Hybrid capital describes the use of mixed forms of capital – debt, equity, and grants – in a way that makes the enterprise more attractive to various types of investors.[13]

Hybrid finance is another term imported by investment bankers and private equity managers with structures more complex than most social enterprises need or understand. To many social enterprises, hybrid may simply mean a structure that brings together in one place a grant, a loan and some form of equity.

It represents an innovative but often complex structure that use a series of contracts and agreements to combine one or more independent business and third sector organizations into a flexible structure that allows the entrepreneurs to conduct a wide range of activities and generate synergies that cannot be achieved in one entity or with one instrument. They seek to combine profit (for the investor) and mission (for the social enterprise). [14]

13 – http://fa-se.de/en/blog-en/hybrid-social-finance-key-to-impact-investing/
14 – *"Financial instruments working with social entrepreneurship"*, 2016, European Commission and European Investment Bank, page 105

FASE 'hybrid' financing deal-by-deal

Finanzierungsagentur für Social Entrepreneurship/ Financing Agency for Social Entrepreneurship (FASE) was founded in January 2013 from within the Ashoka network.[15] *This initiative aims to bring together philanthropic and investing capital for the typical, "hybrid" funding, creating deal flow and closing typical funding gaps.*[16] *Its focus is primarily on social impact investing in Germany and German-speaking countries, although its influence has spread beyond those nations' borders. One of FASE's roles is to act as a broker between social enterprise and sources of funding and to facilitate partnerships. They identify investors and financiers across the entire spectrum, ranging from private investors, family offices and foundations to social investors and banks.*

FASE's objective is to support the development of an impact investment market that will enable more social enterprises to take on repayable finance. It contributes to developing and establishing feasible, suitable and reliable financial instruments. Starting in early 2013, FASE has been successfully established as a new financial intermediary between social entrepreneurs and impact investors. It has built an open pipeline of investment-ready social enterprises and already closed seven transactions between EUR100,000 and EUR500,000 and thereby channelled over EUR2 million investments into the social finance ecosystem. A deal-by-deal support from experts like FASE can be a very effective mechanism to channel hybrid capital to social enterprises in early stages of their growth. This approach has been successfully demonstrated in Germany and Austria with nine closed deals to date, bringing approximately EUR3 million in additional resources to the social finance ecosystem.

Leveraging Grants to Attract Equity Investors

Social entrepreneurs can use a mix of grants and investor money to make themselves more financially attractive to investors. For example, if an enterprise is seeking $10,000 and can only promise a 5% return on its investment, it may not be a competitive investment opportunity. However, if the enterprise gets $5,000 from a charitable grant, it would now only seek $5,000 from investors, and so be able to promise them a more competitive 10% return.[17]

First-Loss Capital and Risk Reduction

Mission-driven investments by foundations can be structured in ways that make future investments by profit-first institutional investors more attractive. For instance, foundations can invest in first-loss capital. This means that if the enterprise were to lose money, the loss is taken out of the foundation's debt/equity before other investors. This structure helps mitigate risk for prospective institutional investors from funds, banks, or corporations.[18]

15 — https://www.centreforpublicimpact.org/case-study/social-impact-financing-agency-social-entrepreneurship-fase/
16 — http://fa-se.de/en/social-entrepreneurs/
17 — A new approach to funding social enterprises - HBR
18 – http://fa-se.de/wp-content/uploads/2016/04/Ashoka-FASE-McKinsey-Achieving-Impact-for-Impact-Investing-2016.pdf

Leveraging Grants to Attract Equity Investors in Romania

One fund focusing on agribusiness in Romania, Treetops Capital Agribusiness Fund LP, included just this type of information in their fund prospectus on Impact Base, an impact fund database. The prospectus notes that 40-50% of the value of each enterprise in their portfolio will be given in the form of a non-reimbursable grant from the EU. The fund notes that this provides a "substantial credit cushion" as well as "enhances returns" as investors see the extra value from these grants.[19]

19 — http://www.impactbase.org/database/treetops-capital-agribusiness-fund-lp#

Mezzanine Financing

Mezzanine financing provides increased security for debt investments. It refers to debt (i.e. a loan) that, if the repayments are not made on time and in full, can be converted into an equity stake in the borrower. This is widely used by the Small Enterprise Assistance Funds (SEAF). Generally, this refers to that layer of financing between senior debt and equity, filling the gap between the two. It can take the form of convertible debt, senior subordinated debt or private mezzanine securities, debt with warrants. It is typically used to fund growth, for owners to take money out of the business or to enable management to buy out owners for succession purposes. Enterprises need to be cash flow positive. When used in conjunction with senior debt, it reduces the amount of equity required. Traditional mezzanine investors are hold-to-maturity investors, generally focused on cash flow lending.[20]

Advantages and disadvantages of Hybrid financing

HYBRID FINANCING	PROS	CONS
Investors	Risk sharing / Investor may be able to secure income streams as security	May be complex and expensive Limited rights
Enterprises	Can be inexpensive / Usually no dilution Risk sharing with investor / Structuring flexibility	Can be complex

20 — A recipe book for social finance, European Commission, page 104

FINANCIAL INSTRUMENTS FOR SOCIAL ENTERPRISES IN SERBIA

Finance is a central issue for social enterprises in Serbia, which face barriers in conventional financial markets as well as declining alternative sources, as international donors gradually withdraw their support. Lack of funds is a problem for social enterprises in different phases of development as research on social enterprises confirm. As stated in a 2012 Development (LEED) programme of the OECD, which was developed in cooperation with Government Unit for Social Inclusion and Poverty Reduction[21], the Serbian financial framework for SME and social enterprise development is underdeveloped in a number of important aspects.

21 — http://socijalnoukljucivanje.gov.rs/ Second Cycle of Policy Impact Assessment: Boosting Social Entrepreneurship and Social Enterprise Creation in the Republic of Serbia

Government institutions

Government institutions that are dealing with the SE sector are fragmented. There is no single public body that could provide more coordinated action to improve the legal and financial environment for social businesses. Public sector is providing financing opportunities to social enterprises through several schemes and institutions. These funds are mostly perceived as non-transparent and inefficient, which large potential that can be better used.

Public sector

ORGANIZATION/SOURCE	ACTIVITY/INSTRUMENT	CONSTRAINS
The Budget Fund	Supports the employment and vocational rehabilitation of PWDs mostly in the forms of subsidies for employment of PWDs	Recognizes only companies for professional rehabilitation
The Lottery Fund	Funds are raised for various social projects, with five funding areas – disability, youth and sport, Red Cross, local municipalities (social protection), and rare diseases	No reports nor available data on the activities of the Fund
The Development Fund	State-funded credits for businesses and new business start-ups, including SMEs and crafts shops	Limited regarding the legal entities: to entrepreneurs (self-employed) and limited liability companies
National Employment Service (NES)	Subsidies for employment of different disadvantaged groups, training and financial support for start-ups, including social enterprises.	Limited regarding the legal entities: to entrepreneurs (self-employed) and limited liability companies
Innovation Fund	Increasing capacities and providing financial support to start ups in innovation and technology. Providing co-financing (mini grants and matching grants)	Limited regarding the legal entities: to entrepreneurs (self-employed) and limited liability companies

Banks

Banking offer for SMEs (including social enterprises) is generally regarded as conservative and risk-averse. LEED OECD 2012, Boosting social enterpreneuship and social enterprise creation in the Republic of Serbia[22] quotes a 2011 Government report issued by the *Ministry of Finance and Economy* concerning the main development problems of SMEs; which are stated as "unfavorable conditions for financing and inappropriate types and scope of financial support – banks with expensive loan offer and short loan period are dominating. At the national and regional level there is a lack of financial instruments which serve real financial needs of SMEs." Social enterprises suffer additional barriers due to banks unfamiliarity with the legal forms used by social enterprise (particularly that of CSOs). Micro finance in Serbia is severely constrained and overregulated, due to its dependence on the commercial banks. Several efforts to change the situation have failed due to the national bank's alleged fear of financial sector instability.

22 — LEED OECD 2012, Boosting social enterpreneuship and social enterprise creation in the Republic of Serbia

Microfinance in Serbia

According to the Serbian Chamber of Commerce report from 2016, during the period 2011-2016. approximately 32,000 micro credits were granted to small and medium-sized enterprises in Serbia. Most micro-credits in Serbia have been approved for production, agriculture and services sectors, and almost 53,000 new jobs have been opened. The average of the approved funds was in average EUR 1.409 per loan, and the repayment period was 22 months. More than half of the approved loans in Serbia, 55 percent, were used by women entrepreneurs.

Comparing to the European average, shows that 390,000 microfinance loans were realized in the EU for two years, and the value of the individual loan was in average EUR 8,500. One of the main obstacles in the development of microfinance in Serbia is the existing legal and regulatory framework, which only allows banks to engage in lending.

At present, only two banks - Erste Bank and Opportunity Bank - have microfinance services and one non-banking institution Agroinvest.

An enabling legal and regulatory framework for microfinancing, development of non-bank financial institutions and other good practices from EU can unlock the real potential for a microfinance sector in Serbia that provides products and services better suited to the needs of SMEs. The total potential portfolio size for microcredit in Serbia is estimated to be EUR 267M, and only 2-7% of this demand is currently being met. Research by the International Labor Organization indicates that if the obstacles to microcredit in Serbia are removed, it would be possible to create from 130,000 to 260,000 new jobs cumulatively over 5 years.

Source: http://www.bep.rs/baza_znanja/documents/access-to-finance/Recommendations for Legal and Regulatory Framework for Microfinance in Serbia.pdf

Banks

ORGANIZATION/SOURCE	ACTIVITY/INSTRUMENT	CONSTRAINS
Erste Bank	The "Step by Step" program of Erste Bank in Serbia supports entrepreneurs with a history of business less than 24 months in empowering their businesses, then social enterprises regardless of the length of their business, as well as new business ideas that characterize sustainability and market potential, offering them access to basic financial products (working capital loans and investments), adequate financial advice and business training, and continuous mentoring after financing. Grace period is up to one year and the loan repayment period is three to five years.	No experiences yet
Opportunity Bank	Providing micro, rural, agro and SME loans to the clients in Serbia with difficult access to financial services. Loans range from 500 up to 10.000 EUR, repayment period 3-60 months, grace period up to 3 months. The interest rate depends on the loan purpose, maturity, amount of collateral and credit history of the client.	High interest rates, and collateral. Limited regarding the legal entities

Other financial support programmes targeting SE

In addition to these financial instruments there are many different grant schemes available to social enterprises. International donors had significant role in supporting development of social enterprise ecosystem in Serbia so far. With the path to EU accession, more finance will become available from different EU funding sources. Relevant for the social enterprises will be fund from programmes including the Instrument for Pre-Accession (IPA); EIDHR (European Instrument for Democracy and Human Rights), Civil Society Facility, EaSI (Employment and Social Innovation), COSME (Competitiveness of Enterprises and SMEs), the European Investment Bank (EIB), which operates through the Western Balkans Investment Framework; the European Bank for Reconstruction and Development (EBRD); the EU's Progress Programme; Lifelong Learning; the Competitiveness and Innovation Framework program (CIP), Entrepreneurship and Innovation Program (EIP) and others.

Although number of international donors is reducing over the years, it is expected that some of the remain donors like USAID, German Development Agency (The Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), Heinrich Boll Foundation, UN Agencies and other international missions will continue to support social entrepreneurship as an answer to CSOs' sustainability, employment and social services for different vulnerable groups and other social problems.

The Step by Step program of *Erste Bank* was created in cooperation with *Startup Alliance* and *Smart Kolektiv* with the aim of economic and social empowerment of startup companies and social enterprises through various packages of educational, financial and mentoring support. The program is aimed at startup companies with a history of business for less than 24 months, new business ideas and social enterprises. The program offers professional support, online education, credit support, mentoring support and networking. The goal of the program is to contribute to the development of the local community, social and economic equality and financial inclusion. The program aims to help 5,000 new jobs to be opened by 2019, provide financing for 500 social enterprises and improve financial stability of 25,000 people who previously had low incomes.

UniCredit Bank and UniCredit Foundation run a programme ***Idea for Better Tomorrow*** providing grants to social enterprises in the range of EUR 5,000 to 8,000. Programme is implemented in partnership with the *Divac Foundation* and *Smart Kolektiv*. So far, EUR 101,000 was awarded. In addition to funding social enterprises receive support in business plan development, marketing and management through trainings, lectures, mentoring and networking.

There are also **local CSOs and Foundations**, such as *Smart Kolektiv*, that are strategically oriented towards the development of social entrepreneurship and are building the network of donors, companies and investors that provide funds and support to social enterprises.

Smart Kolektiv implements ***Smart Academy*** – one year long programme for social enterprises that combines financial and non-financial support, including series of trainings, consultations with experts, mentoring support, partnering with businesses and promotion. Social enterprises have the opportunity to advance their knowledge and skills in the areas of business idea development, strategic planning, marketing, management, partnership with companies and finance. Most successful participants are awarded with funds of up to EUR 10,000 for improving their sustainability. Participants also have access to largest socially responsible companies in Serbia, through the Responsible Business Forum network that is managed by Smart Kolektiv. During 2015-2016, ten selected organizations received 500 hours of expert support working with 30 experts. The most successful organizations were awarded with grants and six months of additional 1-1 mentoring support. As a result, two social enterprises have started new economic activities, while four others have improved their business model, increased production capacities, introduced new services and/or improved their marketing strategies. One of the SE reported 30% increase in sale.

Through the programme ***Plantation for the future*** *Delta Foundation* supports social enterprises that are contributing to local community development, employment and poverty reduction. In cooperation with different partners and supporters, they have provided access to finance, education and market to 17 social enterprises so far. Through grants ranging from EUR 2,000 to 15,000, they have invested a total of EUR 198,550 over the last two years. The programme also provides expert support involving employees of companies owned by *Delta Holding*.

Divac Agricultural Funds is the program developed by **Ana and Vlade Divac Foundation**, aimed at economic empowerment and the support of those who want to start and further develop their own agri-business. Besides the improvement of the position of individual farmers, this project advances the development of underdeveloped areas and municipalities in Serbia. For the selected beneficiaries, this program provides resources to purchase equipment and tools, certificates, additional training and mentor assistance to implement their ideas. Since its establishment, the Foundation has awarded **732 grants** in the value of **EUR 1,384,923** to those who wanted to start or further develop their agricultural production. This includes support to refugees and internally displaced persons to start agricultural production, provided through **RAISE Project** implemented together with **UniCredit Bank** and **UniCredit Foundation**.

Trag Foundation, in partnership with the **Rockefeller Brothers Fund, Erste Bank and Church World Service** is implementing **National Forum for Green Ideas** program for the last 5 years. Puropse of this program is to support inovative entrepreneurial ideas based on the sustainable development principles. Eligible to apply are individuals, association, small businesses and entrepreneurs in the initial stage of development with annual turnover less than 10.000 EUR. Program provides awards for 3 best ideas. Beside financial support, Program also provides additional support to awarded winners in the form of consultations, education and exchange of experiences.

RECOMMENDATIONS FOR THE FINANCIAL MARKET DEVELOPMENT FOR SOCIAL ENTERPRISES

Conclusions and Recommendations

By means of a research and consultative process with representatives of all sectors, in 2017 Smart Kolektiv analysed the needs and challenges for the development of social enterprises, same as the offer of support programmes and financial instruments. On these grounds recommendations were defined for specific actions aimed at capacity building of social enterprises, creating more enabling climate and financial instruments, which are to contribute to realisation of the potential these enterprises can offer to the economy and society.

SOCIAL ENTERPRISES' CAPACITY BUILDING

Support for the more successful business doing and achievement of a greater social impact

The lack of knowledge, human and other resources represent the key barriers to development of business and achievement of a greater social impact for more than 60% of social enterprises. To allow social enterprises to do their business in the market more successfully, be ready for investors and achieve greater impact in the community, they need to be provided with an access to education, structured support programmes for different enterprise development phases and linkages with key stakeholders in the state which could facilitate their development. This requires creation of strong, long-lasting and stable support programmes so as to enable continuous development of this sector.

1. Education in the area of entrepreneurial skills and knowledge - Social enterprises need opportunities to acquire knowledge and skills in the key areas, like: enterprise management, financial planning and management, marketing and social impact measurement. In addition, there is a need for specific knowledge- training and consultants in the following areas: negotiating with customers and investors, models and types of funding, product development and product quality, industry-specific knowledge. Recommended formats for this type of support are: lectures, workshops, consultancy support.

2. Empower teams, not individuals - The whole team needs to be empowered, not individuals on the teams. Enable the teams to participate in the programmes and ensure mentors and consultants to visit enterprises and work with the teams in the field. Enterprises have demonstrated greatest need for this kind of support in duration from six months to one year and from one to three years (depending on their development phase).

3. Development of incubators and accelerators for social enterprises - It is required to develop long-term and structured support programmes tailor made to the development phase and individual needs of enterprises. Organisations setting up support programmes for enterprises need to be supported to empower the greatest possible number of enterprises in the start-up phase of development, assist them in developing a strong team, and in developing and testing their business idea. It is equally important to enable enterprises in the later phases of development to prepare for investors and long-term mentor support after the investment.

4. Cooperation and coordination with incubation and acceleration programmes in the Central and Eastern Europe region - Foster networking and cooperation with similar organisations and programmes so as to develop standards in provision of support, preparation of social enterprises for investment and access to joint funds particularly developed for social impact organisations and enterprises.

5. Increased private sector inclusion in the support - Companies can significantly contribute to the development of this sector by donating their knowledge and skills, promotion, inclusion in their supply chains and funding. The needs of large and medium-sized companies and space for cooperation have to be additionally analysed, examples of good practice promoted and opportunities for linking social enterprises with companies ensured.

6. Provide direct support in accessing the market - A large number of social enterprises have shown a considerable need for direct support in accessing the market. The tools need to be developed for improved diagnostics of the capacities of enterprises, and key barriers and recommendations defined for addressing them, so as to allow enterprises to raise their capacities and chances of entering the major supply chains. On the other hand, an open dialogue needs to be initiated with the public and private sectors, and space and barriers to cooperation and strategy defined targeting at opening these markets to social enterprises.

7. Stimulate networking and cooperation among social enterprises - It is required to additionally stimulate cooperation, learning, exchange of experiences and partnerships among social enterprises. Social enterprises can obtain comprehensive knowledge, access to resources and market by networking with other enterprises and industries (creative ones, for example). Encourage cooperation with the public sector, companies and investors so as to align positions about their joint work and find solution to key social problems.

8. Measuring social impact - This requires developing a standardised methodology for measuring social impact and social impact reporting. Measurement will help organisations and enterprises, donors, investors and representatives of the public sector to better understand impact achieved by social enterprises and the impact of different support measures on the effectiveness of social enterprises' operation. Creating a database of successful enterprises with strong social impact, visible results of their work and information about the methods of support assisting their growth can significantly contribute to raising the awareness on the importance of social enterprises, education in this area and sector growth.

TAILOR-MADE FINANCING FOR SOCIAL ENTERPRISES

Development of new financing instruments and a larger number of funding sources for social enterprises in different development phases

Financing represents a major problem for social enterprises in Serbia, given that the access to the traditional financial market is not enabled for all legal forms and start-ups. On the other hand, the number of alternative sources is small, with the notable trend of international donors withdrawing from the country. According to the research conducted by Smart Kolektiv, even 87.5% of social enterprises have identified funding as the major problem for their businesses. Among the surveyed enterprises, 65% have highlighted the lack of grant sources, while 50% have stressed the need to access loans. There is a strong need for a larger number of programmes and instruments available and adjusted to financial needs of social enterprises.

1. Development of a larger number of financial instruments for enterprises in the early development phase - Access to start-up financing has been recognised as the major problem faced by social enterprises in the beginning of their operation. It is necessary to enable social enterprises in the start-up and validation phases the access to a larger number of grants and soft micro loans to allow them to develop their business ideas. A majority of enterprises in this phase have demonstrated the need for amounts ranging from EUR 5,000 to 25,000, with additional expert support as a part of the process. Key partners in developing such programmes could be the public sector, companies, donors and the European Commission.

2. Improving financing from public funds - Enhance transparency of the existing public sector financial instruments and their openness towards different

legal forms of business. Raise awareness among the sector representatives about the contribution these enterprises can bring to social services, health care, education, culture, employment of different categories of population and innovation in addressing fundamental social problems. Besides the grants and co-funding, advocate other mechanisms like subsidies, tax reliefs, public procurement, etc.

3. Introducing new financial instruments - Learn from the examples of good practice in the European Union and Central and Eastern European countries and test new models of financing like: soft loans without collateral, venture philanthropy or social impact bonds, all proved to be good mechanisms for the sustainable growth of social enterprises. Learn from the needs of local social enterprises and develop instruments created based on their needs and capacities. Enterprises in later phases of development have stated the need for investments ranging from EUR 50,000 to 100,000, however only a small percentage of them are willing to borrow the entire amount under the current conditions. It is required to develop hybrid financing mechanisms combining grants, loans, favourable payback conditions and strong expert (non-financial) support in their development.

4. Encourage investors, donors and companies to invest in social enterprises and cooperate in this process. Promote examples of good practice from the EU, region and Serbia, organise events promoting social enterprises and social investing, work on development of governmental incentives aimed at stimulating investments of this kind. Work together with investors in evaluation of the social enterprises' capacities, understanding their business models and risks attached to specific social problems, and together with investors create models of support for their investees.

5. Develop cooperation with regional social investment funds - In the Western Balkans and Central and Eastern Europe region, social investment funds and instruments are already being developed. Development and cooperation with such funds will enable Serbian enterprises to access to new financial instruments, but also will the development of new funding models for social enterprises, same as the implementation of good practices from other countries in Serbia.

6. Develop cooperation with regional and European financing institutions - Regional stakeholders like the European Commission, European Bank for Reconstruction and Development, European Investment Fund, UN Development Programme (UNDP) and others, can be important partners in setting up or co-funding new financial instruments.

7. **Creating a database of available funds and financial support** - Developing a database of information on the support programmes targeting social enterprises, would be useful both for social enterprises and investors. Besides financial support, the database should contain information about other expert support programmes for all phases of business development, other existing stimulations and regional-type programmes.

A MORE ENABLING ENVIRONMENT FOR THE SOCIAL ENTERPRENEURSHIP DEVELOPMENT

Development of national strategies, policies and more enabling legislative framework for enterprises and financing institutions

Stimulating business environment represents a key precondition for the development of entrepreneurship. According to the research, key problems of social enterprises pertaining to business environment are the lack of grant sources (65.7%), lack of public awareness on the relevance of the problem addressed by social enterprises (57.5%) and lack of governmental subsidies (53.5%).

1. Development of the National Social Entrepreneurship Strategy - Include key stakeholders from all sectors in the development of the strategy and legislative framework which will be more conducive for the development of social enterprises. Establish understanding and definition of the term of a social enterprise at national level, which will take into account different areas and models of achieving social impact and enable sector to grow. The definition and strategy are to be developed in accordance with the relevant and good practices from the region and European Union, however being aware of the specificities of the local ecosystem and practices already in place.

2. Development of the public sector support programmes - It is needed to raise understanding among the public sector representatives about the importance of social enterprises in addressing different social, environmental and public issues and manners in which social enterprises meet their social objectives. Establish a dialogue and cooperation between the public sector, organisations providing support and social enterprises and together work on creation and improvement of governmental support programmes, subsidies and other incentives, which need to be transparent, accessible and adjusted to the needs of active social enterprises. Advocate incentives for specific topics addressed by social enterprises.

3. Stimulate cooperation with the private sector - Inform companies about the different forms of cooperation and partnership with social enterprises and benefits for the companies. The state is to additionally encourage companies by means of a more favourable fiscal policy and linkages between social enterprises and business associations.

4. Improve legislative framework on financing institutions and services - Advocate and together with key stakeholders work on legislative amendments and adoption of laws enabling microcrediting, development of alternative and more favourable sources of funding for social enterprises.

5. Establish a database on social enterprises - Introduce regular research, data collection and statistics needed for monitoring situation in the sector, social impact achieved by the enterprises and efficiency of the support programmes they are beneficiaries of. Social impact measurement and value provided by the social enterprises in the society in the area of inclusion, social services, employment, environment and other areas is particularly important so as to better understand their relevance and create stimulating policies and instruments for the sector development.

6. Development of cooperation and support networks - Development of national and regional networks gathering social enterprises and organisations supporting them, in order to collect, exchange and promote best practices. National platform can be linked with the existing regional and European platforms.

7. Raising awareness on the importance of doing business and social impact of social enterprises - Enhance understanding of all sectors about the action areas and business models of active social enterprises in Serbia and EU. Regularly collect information on the performance of social enterprises, measure their value for the society and promote best examples and their results. Organise public and visible events, campaigns and awards to promote the topic, examples of good practice of social enterprises and examples of successful programmes stimulating growth of social enterprises. Build an image of a social entrepreneur as a sustainable entrepreneurial model contributing to poverty reduction, inclusion, social and economic development and the environment.

8. Motivate and encourage citizens and the public to support social enterprises - By raising public awareness by means of campaigns, encourage citizens to buy products and services from social enterprises and donate funds to support social enterprises.

9. Education and informing - Establish cooperation with universities, vocational schools and relevant institutions and work on the development of mechanisms for promotion of entrepreneurship, social entrepreneurship and employment in social enterprises as a career choice. Enable free-of-charge training for young people in the area of entrepreneurship and social entrepreneurship.

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Smart Kolektiv

Smart Kolektiv is a leading organisation in Serbia engaged in the social economy development. Smart Kolektiv assists social innovators by enabling them access to funding and better market position, networking with the business sector and transfer of business knowledge and skills. Smart Kolektiv identifies ways to apply business experiences and logic in addressing social issues, helps companies to strategically cooperate with the community, and social innovators to raise interest in the business community for their solutions and initiatives. The organisation is a pioneer in promoting the concept of socially responsible business and development of social entrepreneurship in the country and region.

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