Social finance investment instruments, markets and cultures in the EU

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Content

1. Executive Summary

Social finance encompasses the process of resourcing organisations, projects, or individuals committed to meeting social needs with monetary capital. In this sense, social finance encompasses both the income that social economy organisations (SEOs) receive and need to cover their costs, and the investments that they secure in order to grow and develop. So, *social investment* refers to the use of money to achieve both social and financial returns.

Concerning *markets and cultures*, the six TEPSIE countries all feature unique characteristics:

- *Denmark*: The Danish social sector is very much shaped by the Scandinavian welfare state model and thus strongly embedded in the fabric of comprehensive institutional systems. Thus, many social services are operated by the public sector and virtually all of them are financed by the public sector. However, much of this sector has been refocused in the aftermath of the financial crisis, including cuts in public sector jobs which have brought about specific challenges. This situation has put pressure on the country's 'welfare-state' status, with raised demand for new solutions and radical changes in Denmark's welfare system, and thus its social sector.
- *Germany*: The social economy and social finance in Germany are markedly different from the Danish example. In Germany, the field consists of: a sector of free welfare organisations providing social services with a longstanding tradition of social banking; a field of mature and established grant-based organisations; and a nascent field of social enterprise financed through various channels, yet still generally undercapitalised. Although the field of social finance is still small, it has lots of potential for development both in terms of quantity (size of the market) and quality (development and diversification of investors and financial instruments).
- *Greece*: The Greek social economy is not well developed. Despite the gradual developments in the field, the third sector remains fragmented and shaped by an unfriendly environment towards SEOs which lacks financial support mechanisms. Thus, the state is the key player in providing economic incentives and support in the form of national grants and co-financed EU programmes. Informal networks and family support still play a dominant role in meeting social needs.
- *Poland*: In relation to Poland's overall population and relatively short civil society history, the Polish social economy today is quite diverse. Many social economy organisations rely on EU funds and public funds. Poland is one of the first few countries with a percentage mechanism: 1% of personal income tax is channelled to mission-driven organisations, which in total amounts to a relatively significant contribution to the social economy.
- *Portugal*: The Portuguese social economy is not well developed yet in terms of sources of funds. Private welfare organisations which are the major part of this economy in terms of value added and employment are independent from the state in terms of creation and governance, but not in terms of financing of their investment and operating costs which are partially financed by state and EU co-funded programmes. New major actors in the social finance field have not yet appeared in alternative to public funding and the resources the social economy organisations can generate by themselves.

- *United Kingdom*: Although the market in Britain is still embryonic, the British social finance and investment field is the most developed in Europe in terms of numbers, scale, and scope of non-governmental actors involved. While social investment is not the bulk of social finance in the UK (in terms of volume) it does play an important role and we imagine that this will continue over coming years. There are encouraging signs for development, such as the growing numbers of investors and greater experimentation with different kinds of instruments.

In all TEPSIE countries, public funding, earned income, as well as grants and donations play by far the most central roles in resourcing social economy organisations. Overall, there is a tendency for the funding of SEOs to shift from grant funding to earned income, as governments increasingly contract out social service provision. Investment instruments – such as loans or equity investing, or newer instruments such as quasi-equity, mezzanine, or crowdfunding – are not significant in terms of absolute numbers. However, at the national level there are some notable exceptions. For instance, in Britain and Germany, loans from social banks play a significant role as a source of investment and the field of social finance is developing fast.

Similarly, despite some variation, the social investment fields in the TEPSIE countries are still embryonic in their development. In all cases, by far the major player remains the state. This is less so in the UK, where there are a number of social banks and investment funds as well as numerous social investment finance intermediaries (SIFIs). However, it is also worth noting that social investors do not always play a prominent role in the public perception. In Germany, there is a relatively long tradition of social banking, with the first social bank having been founded in 1923 and today's most prominent social bank, established in 1974. So, further research will shed more light on historical trajectories and forms of social finance with successful but largely overlooked traditions. While rightly looking at ways to diversify finance instruments available to SEOs, we also need to unlock the potential for increasing private and corporate grants and donations, for they may be assumed to be particularly important for social innovation.

The relationship between the social economy, social investment and social innovation, remains under-researched and poorly understood both theoretically and empirically. This is because both the fields of social innovation and social finance are still developing and neither has been measured in such a way that a link can be reasonably established. So, both fields require further investigation and research in order to better understand their interrelatedness.

2. Introduction: problem and objectives

Social innovation takes place in all sectors of society, in the public, private, non-profit and informal sectors. Despite some commonalities, the way social innovations are financed often varies from sector to sector. Due to the time constraints of this work package, we cannot look at how *all* social innovations can potentially be financed. As a result, we have decided to focus on the social economy because a) we think the social economy plays a particularly important role in generating social innovations (a hypothesis that we will test over the course of the TEPSIE project); b) because social economy organisations face specific challenges in securing funds and investment and c) also because there is a real gap of understanding in terms of the relationship between social innovation and social finance (not all social finance focuses on social innovation and not all social innovations require social finance. But how can social finance be better deployed to support social innovation? To find this out we need to a) define our terms, especially those relating to social finance and social investment and b) explore the state of social finance in each country. So, although this report focuses on the social economy, it does not do so exclusively. The blurred boundaries of both the 'social economy' and 'social innovation' require that we look carefully at these terms and their boundaries.

In the literature on social innovation, there is no advanced understanding of or consensus on the relationship between social *innovation* and what is called (i) social *finance*, (ii) social *investors*, and (iii) the social *economy* (mission-driven organisations legally independent from the state). For reasons elaborated elsewhere,[1] even though social innovation can take place in all sectors, we assume in this report that *social innovation takes place primarily in the social economy and is resourced by social finance instruments*. This is our working hypothesis even though we recognise that social innovation can and does take place in other sectors, and that where and how it occurs is often context dependent. As such, we begin our analysis of generating capital flows for social innovation by looking at how the social economy is financed and how social finance works.

Social finance consists of three interrelated elements: instruments, investors and investees. The distinctiveness of social finance derives primarily from investee characteristics, but also from the characteristics of investors (particularly their intended returns) and of instruments. That is, social finance is distinct from traditional commercial finance, because a) the organisations/individuals *receiving* investment have primarily social rather than commercial goals (they meet a social need or solve a social problem) or b) *return expectations* are different (investors expect a social return that is generated by meeting a social need or solving a social problem). In reality, and on the empirical level, social finance will usually consist of an interplay between a) and b). However, it is possible and relatively common that a commercial bank makes a loan to a mature mission-driven organisation. On an *analytical* level, a) and b) can and should be viewed and analysed separately; an "ideal-type" of social finance would feature a strong interrelation between a) and b).

As such, the field of social finance consists of finance instruments, investors and investees, with the last two being primarily responsible for making it conceptually distinct from traditional commercial finance. In reality, there are many instances where commercial finance meets a social need too (e.g. SEOs' expansion, development, purchasing new equipment, hiring new staff etc.), so there is some "social finance" in commercial finance. However, in general, the return expectations between social finance and traditional commercial finance are different; and investees using commercial

[1] G, Glänzel & B, Schmitz, 'The Role of the State in the Relation between Various Scaling and Resourcing Approaches of Social Innovation', Working Paper, ISIRC Birmingham, 2012

finance tend not to be primarily concerned with meeting a social need but rather, pursuing their organisational missions. Intended returns and purpose/mission are both *primarily and predominantly* social in social finance.

Based on this conceptual background, this report aims to map the terrain in which capital flows for social innovation are generated. Given our working hypothesis that *the social economy is an important sector for social innovation*, the focus and structure of this report is based on the following questions:

- How is the social economy funded?
- What are the pros and cons of different forms of funding?
- How does funding influence the strategy and organisational development of social economy organisations?
- What kind of returns do investors expect and how can non-monetary returns be shown?

This report focuses largely on the status quo, i.e. the actual status of social finance and investment in TEPSIE countries. This has required the aggregation of highly diverse information and data which in many cases are not comparable scientifically. There have been no comprehensive studies on an international level of the ways in which non-profit organisations are funded since the Johns Hopkins Comparative Nonprofit Sector Project[2] in the early 1990s. So, the information and data used in this report have been aggregated with the primary goal of providing an overall picture as comprehensive as possible which can be the basis of further research and comparisons, rather that attempting to achieve scientific accuracy.

This report is structured into three main parts: first, we outline the basic terminology of the report and provide some important disambiguation, theory and a literature review. The second part consists of data and evidence from the field gathered from the six TEPSIE partner institutions. Based on that, the last part will summarise important findings, identify important trends, develop hypotheses and provide an outlook on current research questions and areas for further research.

[2] Salamon et al., 'Global Civil Society. Dimensions of the nonprofit sector', Johns Hopkins University Institute for Policy Studies, Baltimore, 1999

3. Social Finance and Social Investment

3.1. Terminology and Concepts

Social finance and social investment are complex and multi-layered fields. In this section, we make some terminological distinctions and clarify some major concepts.

3.1.1. Social Finance and Social Investment

When talking about generating capital flows for social innovation from a social science point of view, it is important to distinguish between and define the terms *capital, social investment and social finance.*

In the social sciences, theorists have defined and outlined four forms of *capital*: economic, social, cultural and symbolic capital.[3] This differentiation is useful when analysing social investment in detail, because it provides a scientifically advanced approach to capture the vast multiplicity of aspects involved in the concept of social investment; in particular, it helps to examine the various and heterogeneous forms of capital inputs and returns, their interrelations as well as related actor characteristics and objectives thoroughly.[4] Without neglecting these different forms of capital, we will concentrate primarily on *economic or* monetary capital, i.e. money.

Concerning the concept of *social investment*, at least three approaches should be differentiated: first, social investment traditionally refers to financing social economy organisations (SEOs) and the related development of adequate capital market institutions and instruments.[5] Second, it refers specifically to the use of money to achieve both social and financial goals.[6] In some cases, especially in the UK and USA, it refers only to the provision of repayable finance invested in organisations with a social mission.[7] In this sense, the term is synonymous with 'impact investing'. However, the term is also used, also in a UK context, to denote investments in SEOs with the aim of generating social returns, rather than financial returns.[8] Third, there is a relatively new stream of research conceptualising social investment in broader terms, i.e. as an integrative concept for third sector

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[3] J, Coleman, 'Social capital in the creation of human capital', American Journal of Sociology, 1988, pp. 95–121; P, Bourdieu, 'Ökonomisches, Kapital, kulturelles Kapital, soziales Kapital', R, Kreckel et al. (ed.), Soziale Ungleichheiten, Otto Schartz & Co, Göttingen, 1983, pp. 183–198; RD, Putnam, 'The prosperous community: social capital and public life', Am. Prospect, 1993, pp. 35–42; A, Franzen & M, Freitag, 'Sozialkapital: Grundlagen und Anwendungen', VS-Verlag, Wiesbaden, 2007; RD, Putnam, 'Making democracy work', Princeton University Press, Princeton, NJ, 1993; J, Coleman, 'Foundations of social theory' , Belknap Press of Harvard University Press, Cambridge, Mass, 1990

[4] A, Schröer & S, Sigmund, 'Soziale Investitionen – zur Multidimensionalität eines ökonomischen Konzepts', HK, Anheier et al. (ed.), Soziale Investitionen. Interdisziplinäre Perspektiven, Springer, Heidelberg, 2011, pp. 87–114; A, Nicholls & C, Pharoah, 'The landscape of social investment: A holistic typology of opportunities and challenges', Working Paper, Skoll Centre for Social Entrepreneurship, 2008

[5] Emerson, J & J, Spitzer, 'From Fragmentation to Function. Critical Concepts and Writings on Social Capital Markets' Structure, Operation, and Innovation', Oxford, 2007; A, Nicholls & C, Pharoah, 'The landscape of social investment: A holistic typology of opportunities and challenges', Working Paper, Skoll Centre for Social Entrepreneurship, 2008; CF, Leuschner, 'Moderne Finanzierungsinstrumente für NPO', Verbands-Mangement, vol.3, no.34, 2008, pp. 18–25

[6] Venturesome, 'Financing Civil Society - A practitioner's view of the UK social investment market', 2008, retrieved 17.09.2012, <http://www.cafonline.org/pdf/Venturesome_FinancingCivilSociety_1806091.pdf>

[7] B, Rickey, I, Joy & S, Hedley, 'Best to borrow? A charity guide to social investment', NPC, London, 2011

[8] Venturesome, 'Financing Civil Society - A practitioner's view of the UK social investment market', 2008, retrieved 17.09.2012, <http://www.cafonline.org/pdf/Venturesome_FinancingCivilSociety_1806091.pdf>

research with the aim of capturing multiple forms of common welfare-oriented practices in various sectors.[9] Regarding these different interpretations, we adopt the second usage of the term and take 'social investment' to mean the use of money to achieve both social and financial returns. So, *social finance* refers to the process of resourcing organisations, projects, or individuals committed to meeting social needs with monetary capital. In this sense, social finance encompasses both the income that SEOs receive and need to cover their costs, and the investments that they secure in order to grow and develop.

Historically SEOs have been very dependent on grants. However, income-generating activities are becoming an increasingly important source of finance for SEOs; especially in regions and sectors where support from donations, private philanthropy, public funding are insufficient and/or declining. Income-generating activities may include sales, fees from services or membership, investments or renting property. A sub-category of income-generating activities are referred to as *economic* activities which may be defined as "regularly pursued trade or business involving the sale of goods or services",[10] i.e. they are based on market-type transactions. In contrast, revenue sources such as donations, gifts, or occasional/irregular activities like fundraising events, generally do not fall under this definition of economic activities.[11]

Here, it is also important to distinguish between income and investment. Income refers to money received by an SEO from donations, interest earnings, or as a result of providing goods and services. This income can then be used as working capital to cover expenses (fixed costs, services etc.) or it can be saved as reserves. These reserves can of course be invested in the SEO (development capital), to finance expansion, development, capacity building (e.g. buying new offices, new equipment or hiring new staff). In practice, however, most SEOs struggle to build up reserves for development and expansion; and in some countries such as Germany for example many SEOs are prohibited by law to build up long-term reserves.[12] In order to grow and develop capacity they will therefore seek either donations or investment. Investments can come in various forms – i.e. there are various investment instruments (from loans, patient capital, quasi-equity and equity) which can be used. So, in this sense "capital [investment] is of course no substitute for income, needed to match expenditure on staff and other recurring costs. Capital [investment] has a complementary role in building strong and effective civil society organisations".[13]

3.1.2. Social Finance Instruments

By social finance we are referring to the process of providing financial resources to mission-driven organisations (or individuals). While financing SEOs traditionally has been associated primarily with public sources and grant finance,[14] social finance instruments today may take a variety of forms.[15]

[9] V, Then & K, Kehl, 'Soziale Investitionen: ein konzeptioneller Entwurf' HK, Anheier et al. (ed.), Soziale Investitionen. Interdisziplinäre Perspektiven, Springer, Heidelberg, 2011, pp. 39–86; HK, Anheier, V, Then, A, Schröer & von Hippel, T, 'Leitlinien und Arbeitsprogramm des Centrums für soziale Investitionen und Innovationen', Heidelberg, 2006

[10] ICNL, 'Economic Activities of Not-for-Profit Organisations', Regulating Civil Society Conference Report, 1996, retrieved 29.08.2012, <http://www.icnl.org/>

[11] A, Noya & E, Clarence, 'The Social Economy. Building Inclusive Economies', OECD Report, 2007

[12] K, Birkhölzer & L, Kramer, 'Grundstrukturen und Erfolgsbedingungen innovativer Arbeits- und Unternehmensformen in Sozialen Unternehmungen', K, Birkhölzer, E, Kistler & G, Mutz (ed.), Der Dritte Sektor: Partner für Wirtschaft und Arbeitsmarkt, VS Verlag für Sozialwissenschaften, Wiesbaden, 2004

[13] Venturesome, 'Financing Civil Society - A practitioner's view of the UK social investment market', 2008, p.5, retrieved 17.09.2012, <http://www.cafonline.org/pdf/Venturesome_FinancingCivilSociety_1806091.pdf>

[14] Salamon et al., 'Global Civil Society. Dimensions of the nonprofit sector', Johns Hopkins University Institute for Policy Studies, Baltimore, 1999

Besides funds from public sources, there are the usual instruments that may first of all be divided into debt and equity investments,[16] such as bank loans, bonds, shares, mezzanine and "hybrid capital".[17] Then there are newer instruments such as micro-credit or crowd funding. Whereas "traditional" investment is assessed and valued applying market mechanisms of (monetary) risk and return, social finance is much harder to analyse in such terms, i.e. there is much more complexity involved in the relation between risk and return in the social field. This makes it much harder for SEOs to acquire necessary resources from commercial funders in traditional financial markets. Social finance investors *usually* do not expect a full market level monetary return (although sometimes they do), but rather, seek a (hard to measure) social and/or ecological return.

As with commercial finance, social finance may be further categorised on the basis of the term of the investment (terms longer than a year are referred to as long term investments); in this respect, social finance may differ substantially from traditional commercial finance, for it may involve much longer time periods.[18]

Different instruments confer different rights and responsibilities to investees and investors, such as option rights, voting rights, decisions about personnel or other key organisational decisions, as well as interest payments, transparency and accountability requirements and so on.[19] The particular features of a specific finance instrument will determine the extent to which it is suitable for any investment and the extent to which it meets the needs and preferences of investors and investees as well as the risk level of the investment. In this respect, where the organisation seeking funds sits in the development life-cycle is of particular importance: seed and start-up finance may require more control and co-decision rights for the investor, while growth and expansion may require fewer rights for the investor and a more stable flow of capital for the investee. Therefore, SEOs may require different forms of capital and thus different instruments as they move through their life-cycle.

3.1.3. Social Investors

Traditionally, the social economy and social innovation have been financed largely by the state (and/or particularly in former times large religious institutions like the churches). Today there is a vast variety of social investors.[20]

The first dedicated and professional social investment institutions were founded in the early to mid-1970s to acquire, process, and provide the resources necessary for social investment – and social innovation. What characterises social finance actors is that they provide financial resources

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[15] P, Kim, G, Perreault & W, Foster, 'Finding Your Funding Model', Stanford Social Innovation Review, 2011; W, Foster, P, Kim & B, Christiansen, 'Ten Nonprofit Funding Model', Stanford Social Innovation Review, 2009; L, Gardin, 'A Variety of resource mixes inside social enterprises', Marthe Nyssens (ed.), Social Enterprise. At the crossroads of market, public policies and civil society, Routledge, Oxon; New York, 2006, pp. 111–136
16 FJ, Fabozzi, 'Handbook of Finance', Wiley & Sons, Hoboken, NJ, 2008, p.3ff.
[17] A, Achleitner, A, Heinecke, A, Noble, M, Schöning & W, Spiess-Knafl, 'Social Investment Manual. An Introduction for Social Entrepreneurs', 2011, retrieved 14.09.2012, <http://www.schwabfound.org/pdf/schwabfound/SocialInvestmentManual.pdf>
[18] B, Schmitz & G, Glänzel, 'Organisational Hybridity in Social Finance: A Comparative Case Study', Working Paper, 15th Annual Conference of the International Research Society for Public Management (IRSPM XV), Trinity College, Dublin, Ireland, 2011
[19] A, Achleitner, R, Pöllath & E, Stahl, 'Finanzierung von Sozialunternehmen. Konzepte zur finanziellen Unterstützung von Social Entrepreneurs' ,Schäffer-Poeschel Verlag, Stuttgart, 2007
[20] C, O' Sullivan, S, Tucker, P, Ramsden, G, Mulgan, W, Norman & D, Vascancelos, 'Strengthening Social Innovation in Europe: Funding and Financing', Draft, December 2011

to be utilised for a social mission, i.e. the investment is typically based on some kind of *social return expectation* and may or may not be connected to a *monetary return expectation*. Indeed, social investors are frequently categorised along these two dimensions:[21] on one end of the spectrum we have investors with full market-rate return expectations and on the other end we have investors with no financial return expectations at all and purely philanthropic investment motives. The following illustration may oversimplify that spectrum a bit, but it provides a rough overview of investor motives and their possible return expectations.

Table 3-1 – Investment motives and return expectations

Investment motives and return expectations					
Avaricious capital (profit-maximising)	Socially Responsible Investment (SRI[22]; market-rate of return with social/ environmental considerations)	Hybrid Investment (maximising both social *and* monetary returns; “Finance first”)	Hybrid Investment (maximising both social *and* monetary returns; “Impact first”)	Impact Investment and Venture Philanthropy (impact maximisation with modest/low financial return expectations)	Altruistic capital (impact maximisation with no financial return expectations)
Financial return ⟷					**Social return**

The most prominent examples include social banks (banking institutions usually providing the full product/service range of commercial banks but following a hybrid investment strategy); mutuals and co-operatives (usually with no/low financial return expectations while maximising the benefits for their members); venture capital and social investment funds (SRI and hybrid investment strategies); venture philanthropy and innovation funds (more focused on impact); and impact investors (typically from sovereign wealth or pensions funds with full market rate of return expectation but over a longer time period (30-50 years instead of 3-5).

3.2. Literature Review

3.2.1. Overview

The literature on financing SEOs can be traced back to the late 1980s and early 1990s when the first case studies[23] on social finance were published; at roughly the same time a complementary string of literature dealt with non-profits and voluntary organisations generating new sources of capital

[21] These two dimensions are somewhat analogous and complementary to the profit orientation of organisations, see Alter, K, 'Social Enterprise Typology', 2004, p.7, retrieved 14.09.2012, <http://www.akademia-equal.rops.krakow.pl/UserFiles/setypology.pdf>
[22] Socially responsible investing
[23] R, Grzywinski, 'The New Old-Fashioned Banking', Harvard Business Review, vol.69, no.3, 1991, pp. 87–98

and/or diversifying their existing resource base.[24] Some of the earliest research conducted in this field showed that SEOs were seriously undercapitalised and this remains one of the most universal research findings today; social economy organisations have always faced difficulties in financing themselves.[25] However, in this respect we should also note contrary positions stating that SEOs being *generally* undercapitalised is not entirely accurate[26] and that rather, they may lack finance for certain activities, ventures, or time periods.[27]

The most often cited reasons for these difficulties point to some typical characteristics of these organisations that are significant from the point of view of traditional financing institutions. For example, the fact that they often have no owners to guarantee loans; no assets to use as collateral; no secure generation of financial income and reliance on single-source income such as grants; legal structures which do not allow the sale of shares; and exit strategies for investors are tough to develop. In addition, there are difficulties with regards to investment actors and the relationships (or lack thereof) between them. These include a generally low awareness of social financing opportunities, risk and return discrepancies, high transaction costs, as well as unclear public perception of social enterprise.[28] And finally, there are problems linked to the perceptions held by investors, particularly banks. They have always been rather reluctant to finance SEOs, because of the problems that these organisations face in generating a competitive rate of return on investment and because SEOs are often perceived as too small or too risky for investment. Also, many individuals running SEOs do not have experience of dealing with the market economy and/or the business and financial skills to set up and implement business plans.[29] Again however, there is no universal consensus among scholars of the ‘Social Economy’ (SE). We also need to emphasise that some of these difficulties are not really unique to SEOs. So, although the above mentioned reasons for financing difficulties are often cited, there is also some literature about how SEOs and investors are developing solutions, e.g. by making better use of real estate or other assets in financing (as guarantees or sources of rental income).[30] In this respect, it is clear that many of these

[24] E, Skloot, 'The Nonprofit Entrepreneur: Creating Ventures to Earn Income, New York, 1988; R, Steckel, R, Simons & P, Lengsfelder, 'Filthy Rich and Other Nonprofit Fantasies. Changing the Way Nonprofits Do Business in the 90s', Ten Speed Press, Berkeley, CA, 1989

[25] GSA, Karaphilis & S, Moore, 'Financing Social Economy Organizations', Knowledge Mobilization Paper Series, 2010; A, Schröer & S, Sigmund, 'Soziale Investitionen – zur Multidimensionalität eines ökonomischen Konzepts', HK, Anheier (ed.), Soziale Investitionen. Interdisziplinäre Perspektiven, Springer, Heidelberg, 2011, pp. 87–114

[26] S, Lessans Geller & LM, Salamon, 'The Johns Hopkins Nonprofit Listening Post Project: Nonprofit Investment Capital Roundtable', Communiqué No. 7, 2007

[27] Start-up:
CF, Leuschner, 'Moderne Finanzierungsinstrumente für NPO', Verbands-Mangement, vol.3, no.34, 2008, pp. 18–25
Scaling:
W, Foster & G, Fine, 'How Nonprofits Get Really Big', Stanford Social Innovation Review, 2007; P, Kim & J, Bradach, 'Why More Nonprofits Are Getting Bigger', Stanford Social Innovation Review;
Financial crisis:
S, Lessans Geller & LM, Salamon, 'Michigan Hosts Roundtable on Nonprofit Investment Capital', Johns Hopkins University, Center for Civil Society Studies, Insitute for Policy Studies, 2009; A, Conner, 'How to Survive the Recession', Stanford Social Innovation Review, 2009; BA, Weisbrod & ED, Asch, 'Endowment for a Rainy Day', Stanford Social Innovation Review, 2010

[28] GSA, Karaphilis & S, Moore, 'Financing Social Economy Organizations', Knowledge Mobilization Paper Series, 2010; B, Meehan & K, Jonker, 'The Rise of Social Capital Market Intermediaries', Stanford Social Innovation Review, 2012 ; P, Wheeler, 'Towards a social stock exchange – barking up the wrong tree?', Alliance magazine, 2006

[29] J, Quarter, L, Mook & A, Armstron, 'Understanding the Social Economy', University of Toronto Press, Toronto, 2009

[30] A, Conner, 'How to Survive the Recession', Stanford Social Innovation Review, 2009

problems are related to information issues and thus the need for better and more finance-related information for which some authors point to the potential of new financial intermediaries.[31]

Despite these relativizing aspects, however, it can generally be stated from the literature that SEOs do not fit the commercial rationale of *conventional* finance providers and intermediaries. As a result, in the last 10-20 years these organisations have strived towards professionalization and to become more business-like in their structures and strategies, a process frequently referred to in the literature as the economisation of the social economy.[32] However, it should be noted that some authors argue that this is not a one-way street and that the economisation of social economy organisations is not the only process of change under way in the sector; at the same time, investors and intermediaries are also becoming more interested in sustainability and as a result in social and ecological investment returns. So, in all societal sectors there are drivers towards both economisation and greater sustainability. Their complex interplay is frequently referred to as *hybridisation*,[33] a term and concept which is also reviewed in a critical way by some authors arguing that the 'blurring of sector boundaries' underlying the concept of hybridisation has always had its own deficiencies and shortcomings.[34]

Nevertheless, the trend of non-profits and SEOs becoming more focused on their economics is clearly observable.[35] Major steps in terms of systematically mapping the field of social finance and the 'new' economics of the non-profit sector by tracking their interrelation could be seen from the mid-1990s onward.[36]

In the early 2000s, the need for a more systematic and effective link not only between investors and the social economy but also for a broader and more holistic view of the field of social investment and socially oriented ventures was expressed by increasing numbers of scholars and

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[31] J, Harold, J, Spitzer & J, Emerson, 'Blended Value Investing. Integrating Environmental Risks and Opportunities into Securities Valuation', Skoll Centre for Social Entrepreneurship, Saïd Business School, Oxford, 2007; B, Meehan & K, Jonker, 'The Rise of Social Capital Market Intermediaries', Stanford Social Innovation Review, 2012

[32] BA, Weisbrod, 'To Profit or Not to Profit. The Commercial Transformation of the Nonprofit Sector', Cambridge University Press, Cambridge, 1998; CF, Leuschner, 'Moderne Finanzierungsinstrumente für NPO', Verbands-Mangement, vol.3, no.34, 2008, pp. 18–25; W, Foster & G, Fine, 'How Nonprofits Get Really Big', Stanford Social Innovation Review, 2007; L, Suennen, W, Rosenzweig & C, Indig, 'Perspectives from the Field', Stanford Social Innovation Review, 2011

[33] G, Glänzel & B, Schmitz, 'Hybride Organisationen – Spezial- oder Regelfall', HK, Anheier et al. (ed.), Soziale Investitionen. Interdisziplinäre Perspektiven, Springer, Heidelberg, 2011, pp. 181–204; D, Billis, 'Hybrid Organizations and the Third Sector. Challenges for Practice, Theory and Policy', Palgrave MacMillan, New York, 2010; B, Boyd, N, Henning, E, Reyna, DE, Wang, MD, Welch & AJ, Hoffman, 'Hybrid Organizations: New Business Model for Environmental Leadership', Greenleaf, Sheffield, 2009; A, Evers, RG, Heinze & T, Olk, 'Handbuch Soziale Dienste', VS Verlag für Sozialwissenschaften, Wiesbaden, 2008

[34] B, Schmitz & G, Glänzel, 'Rethinking organizational Hybridity – Towards an analytical framework for hybridity', Los Angeles, USA, October 2010

[35] E, Priller & A, Zimmer, 'Der Dritte Sektor international. Mehr Markt – weniger Staat?', Edition Sigma, Berlin, 2001 R, Wagner, 'Spendenmarkt in Bewegung – Fundraising im Wandel', Verbands-Mangement, vol.1, no.35, 2009, pp. 18–25; P, Kim & J, Bradach, 'Why More Nonprofits Are Getting Bigger', Stanford Social Innovation Review, 2012; T, Straus, 'What Works: Five-Digit Giving', Stanford Social Innovation Review, 2010; P, Hogenkamp & S, Buff, 'Online-Fundraising und seine Tücken', Verbands-Management, vol.3, no.35, 2009, pp. 28–35

[36] Emerson, J & F Twersky, 'New Social Entrepreneurs: The Success, Challenge, and Lessons of Nonprofit Enterprise Creation, San Francisco, 1996; C, Letts, W, Ryan & A, Grossman, 'Virtuous Capital. What Foundations Can Learn from Venture Capitalists', Stanford Innovation Review, 1997; J, Dees, 'Enterprising Nonprofits', Harvard Business Review, vol.76, no.1, 1998, pp. 54–67

practitioners. The most comprehensive approach was undertaken by Emerson[37] who attempted to systematise and categorise the field of social finance/enterprise while at the same time, proposing the 'blended value' concept, which tried to break down the conceptual barriers between the non-profit and for-profit sectors, particularly with regard to investment strategies. The blended value concept aims to highlight *social return*, i.e. the comprehensive set of economic, ecological and societal benefits derived from an investment; if this return is expressible in monetary terms, it is referred to as *social return on investment* (SROI).[38]

However, it has not been possible so far to include both social return and SROI as components of financial instruments in conventional financial markets. The mode of functioning of these markets does not allow for a social return/SROI to be included in asset prices, i.e. in financial instruments. Here, only repayment and monetary return play a significant role. Thus, these markets do not allocate capital to social projects or organisations and financing is a common and overarching problem of the social economy.[39] So, the lack of adequate performance indicators and measurement approaches has so far led to markets for social finance remaining largely underdeveloped. In turn, the problems of financing the social economy are closely related to the lack or insufficiency of adequate return metrics.

Today, the literature on social finance is broad and can be found in almost every social science discipline. Perspectives on social finance vary across disciplines: first, some scholars take a micro-economic or strategic management perspective on the organisation or social project intending to acquire funds; textbooks[40] on non-profit organisation management or social entrepreneurship almost invariably deal with the issue of finance; and much of the newer (journal) literature focuses on developing and implementing *new* ways to secure finance for non-profit organisations/ projects and/or to rethink and revitalise "old" ways and methods. [41] Then second, there is the investor perspective concentrating increasingly on questions regarding decision rights and impact opportunities[42] connected to social finance.[43] And third, there is a perspective focussing on the

[37] J, Emerson, 'The Blended Value Map. Tracking the Intersects and Opportunities of Economic, Social and Environmental Value Creation', 2003, retrieved 17.09.2012, <http://www.hewlett.org/uploads/files/BlendedValueMapFinal.pdf>

[38] REDF, 'Investing in Employment and Hope', retrieved 03.09.2012, <http://www.redf.org/>; S, Olsen & A, Lingane, 'Social Return on Investment: Standard Guidelines', Working Paper Series, Center for Responsible Business, UC Berkeley, 2003

[39] J, Harold, J, Spitzer & J, Emerson, 'Blended Value Investing. Integrating Environmental Risks and Opportunities into Securities Valuation', Skoll Centre for Social Entrepreneurship, Saïd Business School Oxford, 2007; A, Schröer & S, Sigmund, 'Soziale Investitionen – zur Multidimensionalität eines ökonomischen Konzepts', HK, Anheier (ed.), Soziale Investitionen. Interdisziplinäre Perspektiven, Springer, Heidelberg, 2011, pp. 87–114; A, Nicholls & C, Pharoah, 'The landscape of social investment: A holistic typology of opportunities and challenges', Skoll Centre for Social Entrepreneurship, 2008

[40] HK, Anheier, 'Nonprofit Organizations. Theory, management, policy', Routledge, London, 2005; KS, Sealey, J, Boschee, J, Emerson & WA, Sealey, 'A Reader in Social Enterprise', Pearon Custom Publishing, Boston, 2000; J, Wei-Skillern, JE, Austin, H, Leonard & H, Stevenson, 'Entrepreneurship in the Social Sector', Sage, London, 2007

[41] P, Kim, G, Perreault & W, Foster, 'Finding Your Funding Model', Stanford Social Innovation Review, 2011; W, Foster, P, Kim & B, Christiansen, 'Ten Nonprofit Funding Model', Stanford Social Innovation Review, 2009; BA, Weisbrod & ED, Asch, 'Endowment for a Rainy Day', Stanford Social Innovation Review, 2010; T, Straus, 'What Works: Five-Digit Giving', Stanford Social Innovation Review, 2010; L, Suennen, W, Rosenzweig & C, Indig, 'Perspectives from the Field', Stanford Social Innovation Review', 2011; R, Wagner, 'Spendenmarkt in Bewegung – Fundraising im Wandel', Verbands-Mangement, vol.1, no.35, 2009, pp. 18–25; R, Purtschert & L, Furrer, 'Trauerspenden – Ein Fundraising-Instrument mit Potenzial', Verbands-Mangement, vol.3, no. 37, 2011, pp. 24–30; P, Hogenkamp & S, Buff, 'Online-Fundraising und seine Tücken', Verbands-Management, vol.3, no.35, 2009, pp. 28–35

[42] P, Wheeler, 'Towards a social stock exchange – barking up the wrong tree?', Alliance magazine, 2006;

investment tools,[44] their specific characteristics and related opportunities and/or drawbacks.[45] Much of this literature on social finance is grey literature published by foundations, networks, or associations. These numerous reports, accounts, and policy papers frequently take a pragmatic empirical approach to the field, mapping investors, investees and/or investment tools and often including a number of (micro) case studies.[46] A related literature category consists of “plain” case studies highlighting special aspects or developments of single social finance investments or organisations.[47]

One of the most prominent works on resourcing social economy organisations to scale is a Stanford Social Innovation Review article series[48] based on empirical research carried out by the Bridgespan Group[49] on large non-profits founded since 1970. The authors provide a framework for dealing with these organisations’ specifics in their relation to funding requirements arguing that funding organisational growth largely depends on finding a specific source of funds with a *strategic fit* to the organisation’s mission, i.e. to concentrate funding rather than to diversify it.[50]

There has been and continues to be an ongoing debate about the effectiveness of investments in the social economy. Thus, much of the writing on social finance has been done on the topic of innovation *within* and *of* social finance (social finance innovation) emphasising the effectiveness and/or efficiency of investment in terms of impact; as well as critical reflections of that impact focus.[51] The relationship between investment and impact has dominated much of the debate in the last 5-10 years.[52] Two interrelated sub-topics are closely associated: first and one of the most contested areas of debate, explores the most promising instruments for funders – mostly foundations – to make sure their investments achieve maximum impact, both concerning grant-making (e.g. Kramer[53] introduces the term *catalytic philanthropy*) and concerning mission-related

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M, Kramer, W, Ryan & A, Grossman, 'Catalytic Philanthropy', Stanford Social Innovation Review, 2009; P, von Flotow, R-D Häßler & J, Schmidt, 'Umwelt- und Nachhaltigkeitstransparenz für Finanzmärkte Stand und Perspektiven', 2002; P, von Flotow, R-D Häßler & J, Schmidt, 'Evidence concerning the connection between sustainable development and shareholder value', Oestrich-Winkel, 2002; N, O’Donohoe, C, Leijonhufvud, Y, Saltuk, A, Bugg-Levine & M, Brandenburg, 'Impact Investments: An emerging asset class', J.P. Morgan Global Research Paper, 2010; U, Grabenwarter & H, Liechtenstein, 'In search of gamma. An unconventional perspective on impact investing, IESE Business School, 2011, retrieved 17.09.2012, <http://www.iese.edu/research/pdfs/ESTUDIO-158-E.pdf>

[43] C, Letts, W, Ryan & A, Grossman, 'Virtuous Capital. What Foundations Can Learn from Venture Capitalists', Stanford Innovation Review, 1997

[44] A, Achleitner, R, Pöllath & E, Stahl, 'Finanzierung von Sozialunternehmen. Konzepte zur finanziellen Unterstützung von Social Entrepreneurs' ,Schäffer-Poeschel Verlag, Stuttgart, 2007

[45] J, Brown, 'Equity finance for social enterprises', Social Enterprise Journal, vol.2, no. 1, 2006; AM, Eikenberry, 'The Hidden Costs of Cause Marketing', Social Innovation Review, 2009

[46] D, Imbert & I, Knoepfel, '360 Degrees for Mission. How leading European foundations use their investments to support their mission and the greater good', Stockholm, 2011

[47] S, Boss, 'Do No Evil', Stanford Social Innovation Review, 2010; J, Mair, 'Q&A Chris West', Stanford Social Innovation Review, 2011

[48] W, Foster & G, Fine, 'How Nonprofits Get Really Big', Stanford Social Innovation Review, 2007; W, Foster, P, Kim & B, Christiansen, 'Ten Nonprofit Funding Model', Stanford Social Innovation Review, 2009; P, Kim, G, Perreault & W, Foster, 'Finding Your Funding Model', Stanford Social Innovation Review, 2011; P, Kim & J, Bradach, 'Why More Nonprofits Are Getting Bigger', Stanford Social Innovation Review, 2012

[49] The Bridgespan Group, retrieved 17.09.2012, <http://www.bridgespan.org/>

[50] P, Hogenkamp & S, Buff, 'Online-Fundraising und seine Tücken', Verbands-Management, vol.3, no.35, 2009, pp. 28–35; CF, Leuschner, 'Moderne Finanzierungsinstrumente für NPO', Verbands-Mangement, vol.3, no.34, 2008, pp. 18–25; R, Wagner, 'Spendenmarkt in Bewegung – Fundraising im Wandel', Verbands-Mangement, vol.1, no.35, 2009, pp. 18–25

[51] Frank 2012

[52] Grabenwarter/Liechtenstein 2011

[53] Kramer 2009

investment of endowment funds in the form of SRI which may go as far as the call for shareholder activism.[54]

This latter phenomenon is an expression of the second prominent sub-topic in the literature: namely, how the relationship between fund receivers and fund providers has become closer in several ways. Back in 1997, Letts and colleagues [55] argued for foundations to strengthen their ties with the organisations/projects they make grants to in order to increase their chances for success. Letts proposed to orient grant-making more towards the venture capital model, a “comprehensive investment approach” which had “emerged from years of practice and competition” (p. 44). This approach has been debated ever since as *venture philanthropy*[56]*.* There were six main aspects of venture capital that Letts and colleagues suggested that grant-making organisations should pay more attention to: risk management, performance measures, closeness of the relationship, amount of funding, length of the relationship, and exit strategies. In this respect, the notion of social capital has gained more scholarly attention recently.

An issue almost as prominent in the literature as impact and closely related to it is *reporting* and *accounting* of SEOs. When investments are increasingly made to achieve impact, investors and stakeholders need to know what impact consists of and which *measurement* tools exist or can be developed to assess the defined components of impact, as already implied above. Nicholls provides a theoretical and empirical account of the current state of affairs of this issue and – in line with the notion of blended value outlined above – proposes the concept of “blended value accounting”.[57]

To take account of the numerous notions, concepts and terms more systematically, approaches to categorise the social finance/investment field from a dedicated social science perspective have been suggested by Gardin[58] and Nicholls. The latter provides “an empirical and theoretical account of the emergent field of social investment” (p. 93) and develops a two-dimensional typology framework connecting three distinct ideal type *investor rationalities* (means-ends-driven; systemic; value-driven) with three *investment logics* (financial; blended; social/environmental). He then provides four prospects for future research of the social investment field based on the work’s research limitations. To explore the cultural and institutional issues influencing social investment across varying societies; to test the theoretical propositions of the paper in a scientifically sound and empirical way; to analyse investor preferences and rationalities as proposed by the paper; and lastly, to provide an analysis of the organisational structures of supply, intermediation, and demand of social investment.

Laurent Gardin’s ‘substantive approach’[59] based on the classical work of Karl Polanyi[60] aims to identify the complex array of possible resource mixes of social enterprises. In order to reduce this

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[54] Weber-Berg 2008; Imbert/Knoepfel 2011
[55] Letts et al. 1997
[56] John, R. (2006) “Venture Philanthropy – The Evolution of High Engagement Philanthropy in Europe”, Download: www.sbs.ox.ac.uk/skoll.
[57] Nicholls, Alex (2009): ‘We do good things, don’t we?’, Accounting, Organizations and Society 34 (2009) 755–769; also see Glänzel, Gunnar (2010): The Case of Regionalwert AG. Paper presented to the International Conference on *Financial co-operative approaches to local development through sustainable innovation,* Trento. http://euricse.eu/sites/euricse.eu/files/db_uploads/documents/1281096909_n616.pdf
[58] Gardin, Laurent (2006): ‘A variety of resource mixes inside social enterprises’, In: Marthe Nyssens (Ed.): ‘Social Enterprise’, New York: Routledge. Nicholls, Alex (2010): ‘The Institutionalization of Social Investment: The Interplay of Investment Logics and Investor Rationalities’, Journal of Social Entrepreneurship, Vol. 1, No. 1: pp 70-100.
[59] Gardin, Laurent (2006): ‘A variety of resource mixes inside social enterprises’, In: Marthe Nyssens (Ed.): ‘Social Enterprise’, New York: Routledge.

complexity, it is concentrated on the analysis of work integration social enterprises (WISEs) to develop a framework distinguishing several socio-economic agents in the field and their respective relationships. It provides a theoretically grounded and empirically backed differentiation of various types of resources (market and socio-politically embedded market resources, reciprocity-based resources) to highlight and emphasise the importance of non-market resources to WISEs. This approach is very valuable to a European perspective on SEOs, because it takes account of the importance of state authorities and of the various ways WISEs (and SEOs in general) are involved with state actors.

In summary, authors typically conclude that the fields of social finance and social investment require a more sophisticated and dedicated approach. And this must be seen and implemented as an integrated conceptual and systemic set of efforts aimed at developing the social economy as a whole, because it is seen to lag behind its potential in solving social problems, at least in OECD countries. To that end, the particularities of the sector and the related specifics in terms of financing needs must be better captured and integrated.[61]

3.2.2. Contentious Areas and Debates

There is no common consensus on how the fields of social finance and the social economy more generally should develop from now; and also looking back, their past developments are viewed in quite diverse ways. The increasing dominance of economic principles, professionalization and rationalisation should be viewed with critical eyes. In particular, it is doubted whether the principles of the capitalist system, accused of having caused so many of today's most severe social problems, may really be capable of solving these same problems. The tendency to do just that is seen as the "Contradictions of Philanthrocapitalism"[62] which David Bosworth illustrates using the example of education which he relates to numerous other social problems in the US:

> "Any reform movement truly interested in improving student performance would commit itself to rooting out the sources of these often interrelated social ills. Here, however, is where the cultural contradictions of philanthrocapitalism become most obvious, for even as its proponents insist on a strict accountability in the public sphere, they refuse to review the broader social impact of the economic system that has been providing their own excessive compensation. The efficiencies that commend industrial pollution, the downsizing of the white-collar workforce to boost shareholder value, the evisceration of whole communities as plants and services have been sent overseas: the very ethos of rationalization they now would impose on public schools has been complicit in creating social conditions inimical to student achievement."[63]

So while many argue that the field of social finance lacks the infrastructure and, to a certain extent, the professional set of instruments that exist in traditional investment, many see the call for such an infrastructure in a critical light. In this respect, one of the controversial issues is the link between impact and a notion of investment expressing an economic return logic that has traditionally not been so dominant in the third sector. This return logic – as expressed in the emphasis of the importance of impact – is one of the major features critics point out when they talk of the economisation of the third sector.[64]

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[60] Polanyi, Karl (1944): 'The Great Transformation: The Political and Economic Origins of our Time', New York: Farrah & Rinehart.
[61] Mendell, Marguerite and Rocío Nogales (2009): 'Social Enterprises in OECD Countries: What are the Financial Streams?', In: Antonella Noya (Ed.): 'The Changing Boundaries of Social Enterprises', OECD Paper.
[62] Bosworth, David (2011), 'The Cultural Contradictions of Philanthrocapitalism', Society (2011) 48: pp. 382-388.
[63] P. 387.
[64] e.g. Edwards 2008

In this respect, we may point to the debated notion of social investment. Taking a broader perspective on the term *resource*, it becomes clear that traditional (monetary) finance is not the only resource that should be taken into account when looking at social innovation. Indeed, there is a vast variety of resources and mechanisms that are needed for innovation or at least can foster its development, such as quasi-currencies, tokens, store cards, point systems, asset sharing, labour time exchanges ("time banking"),[65] but also more complex instruments such as carbon dioxide certificates. As a result, we should widen our perspective on the prospects for resourcing social innovation and these models and mechanisms should be given more academic and policy attention in this context. Thus, it might be necessary to develop a broader notion of social investment.[66]

Besides these profound and general debates about the way to develop the field, there are several additional open research gaps and areas of debate. Much of today's controversial debates can and will be resolved based on more and better empirical insights to which this report and WP4 aim to contribute.

[65] Judith Lasker, Ed Collom, Tara Bealer, Erin Niclaus, Jessica Young Keefe, Zane Kratzer, Lauren Baldasari, Ethan Kramer, Rachel Mandeville, Julia Schulman, Danielle Suchow, Abby Letcher, Anne Rogers, and Kathy Perlow (2010): 'Time Banking and Health: The Role of a Community Currency Organization in Enhancing Well-Being' *Health Promotion Practice,* January 2011 12: 102-115

[66] Schröer, Andreas and Steffen Sigmund (2011): ‚Soziale Investitionen – zur Multidimensionalität eines ökonomischen Konzepts', In: H.K. Anheier et al. (Eds.): ‚Soziale Investitionen: Interdisziplinäre Perspektiven', Heidelberg: Springer: pp. 87-114.

4. Financing the social economy: evidence from the field

In the following sections, this report gives an indicative overview of the social finance and investment fields of the six TEPSIE partner countries. A word of caution is necessary here: in order to provide a large scale overview of the fields of social finance and social investment in each of the TEPSIE countries, we faced some trade-offs between omitting certain areas entirely and relying on non-validated expert views and/or information from grey literature. Because this report is the first part of an ongoing piece of work, we decided to include the information, even if it requires further validation. In addition, we included data which was not as comprehensive or complete as we would wish. There are currently no comparable data sets relating to social finance and social investment across Europe, so we have used what is available to develop our thinking and cover as much ground as possible. Overall, however, the information presented herein is reliable and balanced.

4.1. Country Overview

While we need to be cautious about the potentially different lenses applied by the various TEPSIE partners, we can state at this stage that we have witnessed very different social finance configurations in all six TEPSIE project partner countries. . In this section we will present a short overview of the fields of social finance in these countries and then develop some synoptic commonalities and differences.

In the following short introductory descriptions, recent developments relating to the current economic crisis and the role of governments in supporting the social economy will be given particular attention. Indeed, the relationship between the social economy and government support will be highlighted due to its importance in terms of country characteristics.

As a first step, the financial relationship between governments and the social economy should be outlined briefly: governments may support the social economy in various forms, mainly financially both directly (by allocating state resources) or indirectly (by granting benefits such as tax exemptions). Direct government funding may also take various forms, i.e. fees on a per capita basis, grants, subsidies, procurement, vouchers, etc. Concerning the sources of these funds, governments often have a variety of options besides traditional tax budgets (such as money from dormant accounts like the British wholesale bank, Big Society Capital (see below) or from privatisation proceeds from which many Eastern European countries resource social economy support budgets). In contrast, no resources are transferred in the case of indirect support; instead, governments waive or forego the revenue that they would otherwise be entitled to collect. Besides tax benefits or exemptions, indirect support can also take the form of free use of municipal property or providing services at lower rates. However, the issue of tax benefits is of particular importance, because it is directly linked to the amount of income available to social economy organisations to pursue their missions. Almost all countries exempt income from grants, donations and membership fees from taxation; income from *economic* activities is often exempted only when it results from “activities related to the purpose” of the organisation (i.e. it passes a “relatedness test”).[67]

[67] Hadzi-Miceva, K. and N. Bullain (2007) ‘A Supportive Financing Framework for Social Economy Organisations’, http://www.oecd.org/cfe/leedprogrammelocaleconomicandemploymentdevelopment/thesocialeconomybuildinginclusiveeconomies.htm

Another criterion to look at when analysing the social finance constellation for any given society is philanthropy. The qualitative and quantitative levels of philanthropy are important indicators of societal support for social economy organisations, which is most often seriously needed. Also, it is an indispensable source for certain types of SEOs and social economy sectors, e.g. advocacy organisations, which are generally less likely to receive support from public sources due to the types of activities they engage in.[68] Therefore, philanthropy and public sources may often play complementary roles when it comes to financing SEOs which is why one should assess its role when depicting the state of social finance in a given society and/or country.

4.1.1. Denmark

Social innovation in Denmark is predominantly linked to innovation within the social and welfare sector, including some main challenges:

- Inclusion, self-determination and empowerment of marginalised groups
- Integration
- Unemployment, especially youth unemployment and activities to mitigate youth unemployment (training; motivational programs etc.)
- A growing ageing population
- Care and service provided for people with physical and/or mental disabilities
- Childhood care and education
- Energy, environmental issues and climate change mitigation.

The aftermath of the financial crisis combined with the long term trend of a relatively declining workforce and the continued problems of integrating the immigrant population have resulted in a new consensus on a need for change in social services. The economic crisis has put pressure on the country's 'welfare-state' status, and resulted in calls for new solutions and radical changes in Denmark's welfare system, via social innovation(s).

Since almost all of the capital available for resourcing social economy organisations originates with the public sector, it is necessary to understand the financial instruments as defined by the public sector. These include the following categories:

- Ongoing annual operating budgets (often set out in legislation)
- Capital investments aimed at buildings, infrastructure, technology and other facilities
- Tendered operational tasks and projects (public procurement)
- Development programs and funding of funds
- Regulation and taxation.
- Charitable/foundation grants
- Earned income
- Bank loans
- Corporate sponsorships
- Membership fees

One set of distinctions becomes very critical for understanding what is going on in terms of social innovation in the country, and also for understanding why precise numbers are very hard to find. In all the main focus areas there are large on-going operations of social services that try to meet identified social needs. Many of these services are operated by the public sector and virtually all of them are financed by the public sector. However, they are not, almost by definition, innovative.

[68] Noya/Clarence 2007 (OECD Report)

They are on-going service operations based on the previous identification of social needs and social innovation, and they are strongly embedded in the fabric of comprehensive institutional systems.

Are we to count these operational services and their finance as part of financing social innovation in Denmark? In many ways the answer is a clear no: maintaining the status quo can hardly be categorised as social innovation. On the other hand, the nature of these needs is always in flux, just as tens of thousands of professionals working in social service institutions continually strive to improve, adapt and innovate their practice, often in ways that pervade the whole system over time. This certainly should be categorised as social innovation, and in terms of finance the money cannot be separated from the operational costs of the system. Aside from this "hidden" innovation as part of operations, there are some more explicit ways of pursuing innovation as systemic solutions are seen to fail or as needs change. They include:

- Project funding (mostly from special funding pools allocated by the responsible public authorities) to explore and experiment with new practices and document results.
- Independent research (often by universities or think tanks) into system failures, uncovered user needs or new practices (including international best practices).
- Changes in institutional set-ups; regulation; control systems; funding mechanisms and key performance metrics; reporting systems; mostly politically or semi-politically driven, often reactively driven by media scandals or perceived system failures.
- Alternative experiments outside the operational, institutional systems, often driven by volunteers or grassroots organisations, sometimes with public sector funding, sometimes funded by foundations or by grassroots contributions. The overall impression is that most of the alternative experiments and innovations have no, or at best marginal impact on the institutional systems, and therefore rarely scale.

4.1.2. Germany

The German social finance field has developed significantly over the last two decades. There is an increasing awareness and sensitivity for sustainability, particularly in the aftermath of the Rio Summit in 1992. The awareness of climate change, other ecological problems and general social conflicts has been increased by corporate and environmental scandals throughout the mid-1990s and early 2000s, and particularly since the current financial crisis which has worsened the overall impression in Western societies that the neo-liberal model has many limitations and needs correcting. At the centre of this neo-liberal model lies the financial world which is why social finance is one of the first sectors where ideas about more sustainable models and practices have been developed, tested, and implemented. [69] Although these forces have started to take off in the last 20 years internationally,[70] in Germany this dates back to the early and mid-1970s where the first social banks were founded (financial co-operatives date back even longer, to approximately the late 19th century). So in general, the seeds for a social finance infrastructure were already in place when the concept of sustainability emerged and became more popular. At roughly the same time in the mid-1990s the CSR trend started to gain increasing acceptance in the corporate world and in complementarity to CSR the investor trend of SRI developed.

So, we see different trends and drivers for the development of the social finance field in Germany, many of which have taken off especially in the last 20 years. In addition we can employ a "proxy"

[69] Dohmen, Caspar (2011): 'GOOD BANK: Das Modell der GLS Bank', Freiburg: orange press.
[70] Schmitz B./Glänzel G. (2011): 'Organisational Hybridity in Social Finance: A Comparative Case Study', Working Paper presented at the 15th Annual Conference of the International Research Society for Public Management (IRSPM XV), Trinity College, Dublin, Ireland.

for social finance from Work Package 2: in Germany, the non-profit sector has developed from 3.9% of GDP in 1995 to 4.1% in 2012, or from 135.4bn DM (~65bn. €) to 98.17bn. Depending on the various needs for finance, the different sections of the non-profit sector should have developed and increased their demand for (social) finance proportionally in that same period; i.e. to meet this demand, the social finance sector has increased its supply over that period (otherwise this growth is hard to explain). However, as we must state from our observations outlined in the following passages, much of the social economy is still financed not through social finance in a narrower sense but through more traditional channels like commercial banks and/or the state.[71] In this respect, one of the major problems for the German social economy shows: the three most important funding sources – the state, earned income and philanthropy – exist in relatively unrelated parallel worlds with their respective peculiarities and specific funding requirements. And these requirements often exclude one another. For example, for an SEO to qualify for public funding, in many cases it has to meet requirements excluding the SEO from acquiring a loan from a bank. The funding requirements as well as the success criteria of the three major funding channels available are too diverse and often conflicting to allow for more diversified resource mixes which are urgently needed to grow the sector sustainably. One of the first attempts in this respect is the co-investment approach of the KfW[72], a state- affiliated bank offering private investors in SEOs a 100% co-investment of up to €100,000.

And also generally, the prospects for the social finance sector seem positive. Besides the trends already set out briefly, a recent survey among impact investors showed that 75% believe that impact investing is "in its infancy and growing", with another 19% claiming that it is "about to take off".[73] However, a major problem facing the sector in Germany is the size of many social economy organisations' financial demands which tend to be relatively limited. Together with information asymmetry problems outlined below, this situation leads to high transaction costs in relation to the actual deal sizes and as a result, high costs overall of social finance activities and management. Indeed, the combined costs for fundraising and acquiring finance in the social finance sector are far higher than the costs of conventional finance.[74]

Many social banks report that they have gained from the crisis in overall terms. First, in general they did not engage in speculative practices or expose their investments to the same extensive risks that many commercial banks did. Thus, on their income side they did not face the losses of commercial banks. And maybe even more importantly, they gained significantly from the crisis, because many more people in Germany became interested in social finance as a result of the harsh critique that commercial banking has been exposed to since the crisis began; and as a result the number of depositors at social banks has increased due to the crisis. The same can be said about other fields of social finance, particularly SRI which is also booming (while still being marginal in relation to the overall market).

In this regard, the German regulation regarding investments of foundations is interesting. In fact, the foundation sector is booming despite the crisis. Its investments are relatively stable due to

[71] Salamon et al. (1999) …
[72] "As a promotional bank of the Federal Republic and the federal states", the Kreditanstalt für Wiederaufbau (KfW) bank group supports "the sustainable improvement of the economic, social and ecological living conditions." http://www.kfw.de/kfw/en/KfW_Group/index.jsp
[73] Saltuk, Y. / Bouri, A. / Leung, G. (2011): Insight into the Impact Investment Market - An indepth analysis of investor perspectives and over 2,200 transactions, J.P.Morgan, http://www.thegiin.org/cgi-bin/iowa/resources/research/334.html
[74] Martin, Maximilian (2007): ‚Social Entrepreneurs und Wealth Management: Wie man die Nachfrage strukturieren und echte Wirkung erzielen kann', in: Achleitner, Ann-Christin, Pöllath, Reinhard and Erwin Stahl (2007): Finanzierung von Sozialunternehmern: Konzepte zur finanziellen Unterstützung von Social Entrepreneurs, Stuttgart: Schäfer-Pöschel.

conservative investment law. Legislation does not allow risky investments to ensure capital preservation (*Kapitalerhaltungsgrundsatz*). For example, foundations are not allowed to invest in shares or make other risky capital market investments such as speculation or gambling. Foundations have to make investments with the expectation of a positive return on investment.[75] Furthermore, capital earnings must be used in the fiscal year of their generation. As a result, German foundations' capital has not been affected significantly by the downturn of the stock market adding to the overall strength of the philanthropic sector to support the social economy. However, low interest rates for investments lowering the amount of earnings available for SEOs' support remains a problem.

Apart from that, the role of the government and particularly the regulatory environment for the social economy is still critical – and can act as a barrier to social innovation. In particular, the bureaucratisation of financing schemes of public and large private resource providers (such as foundations) should be reversed or reduced. Regarding public funding, (which is still the most important source of social finance) critics call for the reduction of the prevalence of "St. Matthew's Principle", namely the allocation of resources to successful and already well-resourced organisations while neglecting small organisations struggling to make it through the "valley of death". As such, there is a need for more diverse, complementary and also venturesome resource strategies. In particular, the German "Zuwendungsrecht" (legislation for the funding of free social welfare organisations) should be reformed to allow small start-ups to receive funds for providing social welfare services without being a member of one of the free welfare associations.[76] Similarly, forms of hybrid capital are becoming more important to social enterprises, but their application often fails because of legal problems, particularly tax regulations. And finally, more explicit support of social innovation in existing German social law, regulations and particularly in public procurement laws and guidelines is called for. Some of the debated shortcomings of the current system and suggested reforms include:

- Restrictions on the financing options and processes for social enterprises from governmental/public sources; currently, there are numerous bureaucratic restrictions in place hindering the success of social enterprises. Both possibilities to lift these restrictions and for new instruments (e.g. social impact bonds) to circumvent them are required and the need for reform is currently being discussed among policymakers.
- Forms of hybrid capital are becoming more important to social enterprises, but their application often fails because of legal problems, particularly tax regulations.
- More explicit support of social innovation in existing social law and regulations – and also in public procurement laws and guidelines is necessary.
- The German "Zuwendungsrecht" (legislation for the funding of free social welfare organisations) should be reformed to allow small start-ups to receive funds for providing social welfare services without being a member of one of the free welfare associations.77

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[75] Schlüter, A., S. Stolte, and E. Manteuffel. 2007. Stiftungsrecht – Erscheinungsformen und Errichtung der Stiftung, Stiftungsaufsicht, Verwaltung des Stiftungsvermögens, Besteuerung von Stiftung und Stifter, Internationales Stiftungsrecht. München: C.H. Beck.

[76] Birkhölzer/Kramer 2004; also see http://www.b-b-e.de/fileadmin/inhalte/themen_materialien/engagementpolitik/nfep_synopse_2010.pdf

[77] Birkhölzer/Kramer 2004; also see http://www.b-b-e.de/fileadmin/inhalte/themen_materialien/engagementpolitik/nfep_synopse_2010.pdf

4.1.3. Greece

In Greece it is commonly acknowledged that the social economy is not well developed. Despite the gradual developments in the field, the third sector remains fragmented. The main causes for this situation are the absence of a clear regulatory framework and the insufficient funding of social economy activities and organisations. SEOs gain substance and contribute to society only when they are supported by funding programmes and financial tools. Greece is characterised by an unfriendly environment towards third sector organisations as it lacks financial support mechanisms (e.g. official programmes targeting social economy entities) and financing tools.[78]

The state is one of the key players in providing economic incentives and supporting SMEs. It has developed special funding tools and mechanisms, mainly in the form of different funding programmes, the Credit Guarantee Fund for Small and Very Small Enterprises, and also various national programmes reinforcing the entrepreneurial activities of SMEs. However, given the special characteristics of SEOs, there is no such financial reinforcement for them due to several reasons. First of all, social enterprises are per se excluded from the Greek banking system. This is mainly due to their inability to safeguard respective guarantees, low returns on capital and also due to their precarious viability given their mainly non-profit character. Moreover, they are usually excluded from receiving funding from different EU programmes as a result of limited information about the existence of such programmes. They are also faced with a significant lack of expertise in drafting proposals, an inability to cover their own funds, a lack of management experience and expertise to claim and use modern funding methods and tools, as well as a lack of clear business plans for defining and planning specific funding needs. They are also reluctant to undertake significant risks (especially for loans).[79]

In order to support the viability and scalability of social enterprises, it is imperative to form new financial tools or reinforce existing ones. Given the current economic situation of Greece, there is a need for coherent factors to be put in place enabling the development of a structured and strong social enterprise sector in Greece. Therefore, a relatively intriguing question was put on the agenda: "*what role is there for the social economy and social enterprises in helping pull Greece out of its dire situation and in strengthening the economic and social fabric of the country?*" This speculation was also put forward in the respective Communication from the Commission "Growth for Greece".[80]

Although in general, SEOs have developed quite a negative image, often characterised by corruption and close collaboration with political networks, a lot has been done towards the development of a coherent and solid social enterprise sector in Greece. An example is the adoption of Law 4019/2011 which provides a legal framework for the development of the social economy and social enterprises in Greece and established the Social Economy Fund.[81] According to the Communication from the Commission (2012),[82] a very specific action for 2012 for Greece in this

[78] EQUAL, National Thematic Network "Activities in the Social Economy Sector", Policy Proposals, September 2005.
[79] Εθνικό Θεματικό Δίκτυο για την Κοινωνική Οικονομία, 2006, «Πρόταση Δημιουργίας Πλαισίου για τη θεσμική, διοικητική και χρηματοδοτική στήριξη των πρωτοβουλιών που αναλαμβάνονται στον τομέα της Κοινωνικής Οικονομίας στην Ελλάδα»,Κοινοτική Πρωτοβουλία EQUAL.
[80] László ANDOR, Commissioner for Employment, Social Affairs and Inclusion, "Social entrepreneurship as an engine for job-rich growth and social cohesion – also in Greece", Concluding remarks, 1st meeting of the Commission's Group of Experts on Social Entrepreneurship, Brussels, Charlemagne, 5 June 2012.
[81] http://www.taxheaven.gr/laws/law/index/lawnumber/4019%252F2011
[82] EC, 2012, COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN CENTRAL BANK, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE, THE COMMITTEE OF THE REGIONS AND THE EUROPEAN INVESTMENT BANK "Growth for Greece", COM(2012) 183 final.

respect should be to make more use of the available European Social Fund[83] resources whereby a fully functioning framework to support the social economy and social enterprises will be put in place. Another example is the earmarking of €60 million of ESF funding for the support of social enterprises as well as respective financing instruments. Towards this end, Commissioner Andor also pinpointed the fact that based on current discussions with the Greek government they envisage the launch of a specific support package indicating the best use of ESF resources as a means of developing a solid ecosystem for Greek social entrepreneurship. Indicatively, this package will be based on three action lines starting with the support to teams starting and developing a social enterprise, support to organisations or teams providing information, advice, coaching and mentoring services to social enterprises in their start-up, development and growth phase and also support through loans and guarantees for social enterprise development and expansion.[84]

4.1.4. Poland

In the last 20 years, the field of social finance in Poland has developed very dynamically – especially thanks to EU support. There is a very big difference between social finance 20 years ago and today's reality in Poland, while the financial/economic crisis has not had such a big influence on social finance and social innovation in the country.

In relation to the country's overall population and relatively short civil society history, the social economy in Poland is quite diverse. There are about 75,000 associations and foundations, 5,500 economic self-government organisations, 350 cooperatives, 900 mutual insurance societies and other mutual organisations, 120 social cooperatives, and more than 94,000 social integration centres (CIS) and social integration clubs (KIS). Most of them are based on EU funds and public funds and their activities in the area of social innovation is dedicated to the "soft side" of this process. That is, thanks to EU projects there is huge potential for changing mindsets and creating new spaces for collaboration based on developing "soft skills" – for example thanks to EU support it is possible to improve the quality of communication, team building or creativity.

However, in terms of social finance and EU support at the national level, the most important types of intermediary in Poland are relevant ministries. Meanwhile, at the regional level, there are administration institutions supported by foundations, which play a key role in the intermediation of social finance.

The biggest barrier facing the social finance field in Poland is the lack of instruments and tools to enable the valuation of social entities and value management systems for the social economy. There is a gap between commercial activities and social aims which has led to very low levels of cooperation between banks, companies and corporations in the area of social economy and social innovation.

To add some momentum to the field, there are several government initiatives currently under way: there is a draft-concept in Poland to create a Social Economy Operational Programme starting in 2013. And in September 2012, a pilot scheme of the loan fund for social entities with the budget of 30 Millions PLN will be created.

In the context of the Polish social economy, it is necessary to mention the Operational Programme Human Capital[85] implemented by the European Commission and the European Development Fund

[83] The most important EU programmes for the Greek social economy are the EQUAL programme, the INTEGRA programme and the HORIZON programme funded by European Social Fund.
[84] László ANDOR, Commissioner for Employment, Social Affairs and Inclusion, "Social entrepreneurship as an engine for job-rich growth and social cohesion – also in Greece", Concluding remarks, 1st meeting of the Commission's Group of Experts on Social Entrepreneurship, Brussels, Charlemagne, 5 June 2012.
[85] http://www.efs.gov.pl/english/Strony/Introduction.aspx

and channelling resources of €11.5bn to Poland's (social) economy. As the main objectives of the Programme include "increasing the employment rate and enhancing social cohesion", its effects on the social economy are significant in its 9 priority areas, which are implemented in a parallel way on the central and regional level. These priority areas are: employment and social integration, development of human resources, development of enterprises, improvement in the health condition of working persons, high quality science and education, including higher education, and, good governance. Priorities implemented at a regional level are: the labour market open for all, promotion of social integration, regional human resources of the economy, development of education and skills in the regions.

The state is the largest investor in social innovation, and public funds are the biggest source of capital for social activities and social innovation. In this respect, it is also worth noting that Poland is one of the first few countries with a percentage mechanism: 1% of income tax of individuals is channelled to mission-driven organisations which in total amounts to a relatively significant budget to the social economy.[86]

4.1.5. Portugal

Public/government funds are, by far, the main source of social finance in Portugal besides the resources the social economy organisations can generate by their own activities (fees paid by users of their services, other goods and services they sell, donations and other private transfers). These include mostly current transfers, followed by subsidies on production. The estimated share of public/government funds in the total revenues of non-profit organisations are at 41%. Due to the reliance of the social economy on public funds, what can be said about finance instruments for social innovation in Portugal is almost entirely about con's rather than pro's: they lack diversity and have a narrow scope. They lack diversity because they tend to come in the form of public/government funds and private transfers (prizes awarded by some private foundations or charitable donations). And they have a narrow scope because they scarcely go beyond the prototype phase of the innovation process.

As a result, social investees' challenges are basically twofold: financial constraints and the legal framework in which they operate. The financial constraints relate to the fact that SEOs often face difficulties in finding match funding which is often a requirement of public or private funding. In most cases it is so because the income earning activities of their organisations are often limited (e.g. they work for people who cannot pay the full price of the services they get; the private donations don't cover for this deficit). The legal framework is another challenge. In a country with a very long tradition of centralistic public administration, command and control policy instruments are abundant. Also they are designed and managed with participation by the citizens they are supposed to help.

Concerning social *innovation*, currently in Portugal there are no public programmes specifically targeting the financing of social innovation. It was not the case some years ago when the EU sponsored EQUAL initiative was in place, but this initiative is over and was not replaced.. Nevertheless, the reason why public funds can still be considered as the major source of finance for social innovation is because they are a major source of funds for social economy organisations both in terms of current revenues and in terms of investment funds. As most social innovation happens through social economy organisations, public funds play an important role here.

[86] Hadzi-Miceva, K. and N. Bullain (2007) 'A Supportive Financing Framework for Social Economy Organisations', In: http://www.oecd.org/cfe/leedprogrammelocaleconomicandemploymentdevelopment/thesocialeconomybuildinginclusiveeconomies.htm

The major social investors in Portugal, that is, the public authorities and the major foundations with large financial means to engage in this kind of activity, both lack a relevant resource to be effective in their efforts to promote social innovation. They don't have enough people on the ground throughout the country to gather sufficient knowledge about the social needs and the potential social dynamics to respond to those needs in an innovative and effective way. They rely on a limited network of connections with the relevant stakeholders on the ground and on what comes to them as demands for funds either spontaneously, or in the framework of programmes they set up. Their own capacities to evaluate these applications for funds are limited (some outsource the evaluation of the applications), as well as the capacities to effectively monitor the social impact of the projects they support.

Concerning the use of social investment in recent decades, social services facilities, cultural and recreational facilities were built and agricultural cooperatives modernised. So, it is fair to say that in many cases these investments responded to social needs that were not well met before. It is also fair to say that there are many cases where these investments substantially improved the quality of the services provided to the population. Another point worth mentioning is that even though investment in physical facilities has been prominent, there has also been progress in human capital with the recruitment and training of more qualified personnel. There is a long way still to go in this domain and training programmes may not always have been designed the most adequate way to improve the performance of social economy organisations, but it is fair to say that the situation of these organisations in terms of human resources is much better than 30 or even 20 years ago. About training, a positive change has been the action training projects for social economy organisations implemented since 2008, with the support of the EU co-funded programme called POPH which will end in 2013.

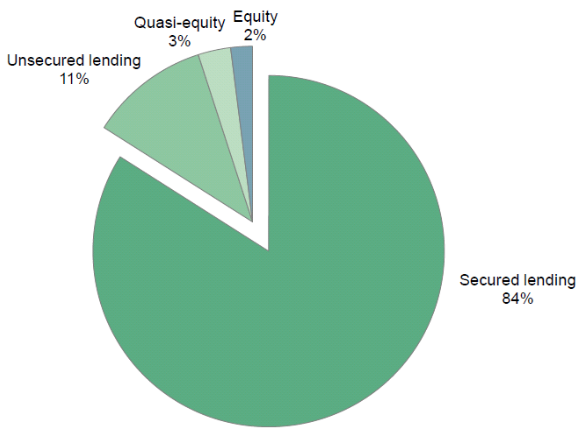
Looking into the future, for obvious reasons, public funds cannot play the same role in future decades as they have done in the last decades in terms of social finance. More will have to come from voluntary private contributions both from individual citizens, and from corporations.

4.1.6. United Kingdom

In the UK, the field of social finance and investment is most developed in Europe both academically in terms of publications on the subject as well as practically in terms of numbers, scale, and scope of actors involved. Besides the traditional importance of the British finance sector, there are a number of reasons for that and recent developments that have added to it.

While social investment is not the bulk of social finance in the UK (in terms of volume) it does play an important role and we imagine that this will continue over coming years. In particular, with the arrival of Big Society Capital (the new social investment intermediary established earlier this year) we imagine that the landscape will change quite dramatically in the next few years. The social investment market is still very embryonic but there are encouraging signs – there are more investors and greater experimentation with different kinds of instruments.
The pie chart below shows the share of social investments made in 2010 by type:

Figure 4-1 – Share of social investments by type, 2010



Source: Big Society Capital Survey[87]

While successive governments in the UK have envisaged a greater role for charities and social enterprises in the delivery of public services, these organisations have faced a number of challenges in accessing either traditional grants or commercial finance for capital investments, and growth capital in particular. Mission driven organisations have also faced difficulties in building capital reserves which means that many are often unable to deal with cash flow difficulties or invest in growth and development. As a result, successive governments have made the development of a social investment market a key third sector policy priority over the last decade. The social investment market aims to fill the gap between traditional grants and mainstream finance. There are now a range of funds, instruments, intermediaries and organisations which work with a range of social mission organisations and blend financial and social returns.

In the last two decades, there has been a significant shift away from grants towards service contracts for mission driven organisations, especially social enterprises and large charities. Statutory funding of the voluntary sector has increased from £8.4 billion in 2000-2001 to £12 billion in 2006-07; £4.2bn of the statutory funding in 2006-07 was received as grants, down from £4.6bn in 2000-01, whilst contract funding increased over the same period from £3.8bn to £7.8bn.[88] There is also growing appetite among charitable foundations to invest in rather than simply distribute grants to mission driven organisations. This interest has found form in the emergence of venture philanthropy and growing interest in mission connected investment and social investment.[89] Also adding to this investment logic, the dramatic growth of the socially responsible investment market over the last decade could provide much needed capital to the social economy in coming years. This market is growing rapidly; research conducted by Robeco suggests that the SRI market will become mainstream within asset management by 2015, reaching between 15%-20% of total global Assets under Management ($26.5 trillion) and total revenue of approximately $53 billion. In

[87] This breakdown only includes the provision of finance to generate both social and financial returns. A Brown, W Norman, *Lighting the touchpaper. Growing the Market for Social Investment in England*, Boston Consulting Group and the Young Foundation, London, 2011
[88] Summarised in R Macmillan, *The third sector delivering public services: an evidence review,* Third Sector Research Centre Working Paper 20, 2010
[89] See for example, Margaret Bolton, 'Foundations and Social Investment', 2005; Kramer, M and Cooch, S. 'The Power of Strategic Mission Investing' *Stanford Social Innovation Review* 2007; New Economics Foundation, Mission Possible: Emerging opportunities for mission-connected investment, London, New Economics Foundation, 2008

the UK, research conducted by the UKSIF estimates Assets under Management in the UK as £938.9 billion (as of 31st December 2009), representing a 19% increase compared with end 2007.[90]

With the current economic crisis, the social economy has entered a period of uncertainty - increasingly, the social economy is being compelled to innovate and fill gaps in terms of meeting social needs that are unaddressed by the public and private sectors. [91] At the same time, public sector cuts in the UK have impacted heavily upon voluntary organisations. Funding for charities has been cut by over a third, resulting in one in ten charities fearing they will close this year. Additionally, two-thirds are cutting frontline services and three-quarters are making staff redundancies.[92] The growing strain on public sector resources has led to greater pressure on voluntary organisations to become less reliant on a single stream of income. Voluntary organisations are increasingly moving away from traditional models of fundraising, diversifying their revenue streams and becoming more business-like in order to ensure their sustainability.[93] The trend towards diversification partially explains the rise in the number of social enterprises in recent years.

Others have argued that investors are more risk averse as a result of the crisis. This does not bode well for the development of the social investment market as financial returns are often already quite low (in comparison to other asset classes) and these investments might not seem attractive to potential investors. [94] However, not all social economy organisations are struggling; the co-operative sector has been particularly resilient and most interestingly social and ethical banks have been faring very well over the last 18 months: "in these tough times, more and more people want to work with an actively ethical and transparent bank, like Triodos. They can see the financial benefits of investing in the growing environmental and ethical sectors and at the same time want to help organisations making a positive difference".[95]

However, the link and relationship between social innovation and social finance is not clear or easy to answer. Not all social finance relates to social innovation; in fact very few of the organisations above have the explicit aim of supporting social innovators or social innovations. Rather, the aim is to better support social entrepreneurs, social enterprises and social impact rather than social innovation per se.

The government plays a significant role in resourcing social innovation, but this is very difficult to quantify. The government resources innovation in two ways: by providing funds for investment and by commissioning goods and services. There are many government funds which could potentially support social innovators but are not specifically designed to do so. But equally, many of these funds might not necessarily fund social innovations. The government also resources innovation through procurement and commissioning. Estimates from the NCVO suggest that charities received £8 billion in public sector contracts in 2009 - twice as much as they received from statutory sources in the form of grants. This £8 billion represents 10% of all public sector procurement in England.[96]

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[90] Robeco and Booz and Company, *Responsible Investing: A Paradigm Shift – from Niche to Mainstream*, Robeco and Booz and Company, 2008

[91] SR Smith, 'The Nonprofit Sector' in M Edwards (ed.), *The Oxford Handbook of Civil Society*, Oxford University Press, Oxford, 2011, p. 38

[92] S Hedley, I Joy, *When the going gets tough: Charities' experiences of public sector commissioning*, New Philanthropy Capital, London, 2012

[93] A Nicholls, 'Social Enterprise and Social Entrepreneurs' in M Edwards (ed.), *The Oxford Handbook of Civil Society*, Oxford University Press, Oxford, 2011, p. 82

[94] Clearly So, *Investor Perspectives on Social Enterprise Financing,* Report prepared for the City of London Corporation, City Bridge Trust, and the Big Lottery Fund, London, Clearly So, 2011

[95] http://www.philanthropyuk.org/quarterly/articles/recession-investors-seek-different-sort-return

[96] Summarised in R Macmillan, *The third sector delivering public services: an evidence review,* Third Sector Research Centre Working Paper 20, 2010

The government has also played a key role in shaping and growing the social investment market. Many of the key organisations in the sector were established with public funds (BLF, UnLtd and Social Investment Business) and some continue to be Non Departmental Government Bodies. The government has actively set up a range of organisations (most recently Big Society Capital) which themselves play a role in resourcing social innovation.

There are several issues currently under debate especially in the British context. These include: whether or not and to what extent Big Society Capital[97] will become a success; the reliance of third sector organisations on public funding; investment readiness is a big issue (a common complaint is that there is a lack of 'credible investment opportunities' in the social sector and that many social enterprises are not ready to secure investment or compete for public service contracts); non-financial kinds of support for third sector organisations; the development of new financial products and investment vehicles; programme-related investment and mission-connected investment; crowdfunding; as well as metrics.

4.2. Markets and Cultures

In the following sections, we will set out the social finance markets and cultures in the six TEPSIE countries based on data provided by each partner institution. As already revealed in the previous section, the state of the social investment/social finance sectors in the respective countries is also evident in the amount and quality of data available. As a result, it is hardly surprising that there is much more data available for the social finance field in the UK than for other partner countries, given the fact that social investing in the UK has been developed systemically over the last decade.

4.2.1. Instruments

As will be set out in the following sections, not all of the following means for generating capital flows are investment instruments in a strict sense. But they are all more or less important sources of funding for SEOs and thus directly or indirectly for social innovation. This is particularly true for earned income strategies of SEOs and grant finance.

Income

With the term 'instruments' we are referring to investment instruments in a traditional sense. As already set out above, it is commonplace for organisations to finance investments from internal sources like income and/or reserves. However, income is not a traditional investment instrument. Nevertheless, earned income strategies are becoming more important and often even paramount in all TEPSIE partner countries for different reasons. So although we will not focus on income as an investment instrument, we do consider it an important means for *generating capital flows*; principally, the 'pecking order' theory of finance also applies to the funding of innovation within SEOs: this theory states that the source of capital preferred by firms to finance innovation activities is internal.[98] And there is a variety of interesting options available to policy makers and social finance providers to utilise SEOs' income mix as a vehicle for fostering the social economy in

[97] In 2010, the government of the UK committed "to using ***all*** dormant accounts money available for spending in England to establish a social investment wholesale institution. This 'Big Society Bank' will develop and grow a sustainable market for social investment in the UK." This institution was then "established to develop and shape a sustainable social investment market in the UK." Besides funds from dormant accounts (accounts that have not be touched for 15 years), Big Society Capital is resourced from major British bank Barclays, HSBC, Lloyds Banking Group and RBS. They "have agreed to invest £50m each in Big Society Capital." BGS was launched in April 2012. http://www.bigsocietycapital.com/

[98] FINNOV, 'Experimentation: Final Policy Report', Work Package 3.6, 2011

general and social innovation in particular. Therefore, we need to consider this potential source of investment closely although it is not an investment instrument.

In the UK, although in terms of investment, loans (from social banks, commercial banks, from the government via social investment business) and grants are the most important source of investment (in terms of monetary volume), earned income is the most important source of income for mission driven organisations. There is growing pressure on mission driven organisations in two senses – first, they are increasingly expected to compete for public service contracts to deliver public services and second, there is more competition for grants. This has compelled many mission driven organisations to develop organisational strategies that are not based on grant funding. So increasingly, many mission driven organisations have a trading arm (i.e. charities with a trading arm) or trade more generally (social enterprises). These mission driven organisations selling goods and services face particular financing challenges. Many organisations are moving away from traditional models of fundraising, diversifying their revenue streams and becoming more business-like in order to ensure their sustainability.[99]

They are often unable to access mainstream finance (because of a lack of understanding about risks/returns on the part of commercial banks) and/or grant funding because they are not charities (which is often a requirement in the UK for receiving grant funding). So, over the past decade there have been concerted efforts by successive governments to help grow the social investment market to fill this gap and meet the financing needs of social enterprises.

This is closely related to changes in the way that public services are being commissioned as successive governments have made a drive to contract out public services. Since 2003/04, earned income has been the voluntary sector's most important type of funding. In 2009/10 earned income accounted for 55% of the sector's total income equating to £20.1 billion. Over four-fifths (84%) of this income is earned through charitable activities (such as delivering services under contract), with the remaining 16% earned through fundraising activities.[100] However, this data omits large sections of the social economy because it is focussed on the voluntary sector.[101] It therefore excludes social enterprises and co-operatives which generate profits and distribute a proportion of these to their members or owners. By definition, the most important instrument for social enterprises is earned income through trading.[102]

In Germany, there are many sources for earned-income strategies resulting in a very complex income "landscape" made up of grants tied to certain conditions and/or the provision of services and the engagement in certain fields of activity, economic activities, cross-subsidisation from trading arms, and most importantly, legally regulated quasi-markets from which large parts of the social economy receive their income. Here the government, federal, community or other state-related bodies pay for certain services on a per capita basis ("sozialrechtliche Leistungsfinanzierung"). It needs to be emphasised that this form of financing is of major importance to the social economy and per-capita service payments are the single-largest source of

[99] A Nicholls, 'Social Enterprise and Social Entrepreneurs' in M Edwards (ed.), *The Oxford Handbook of Civil Society*, Oxford University Press, Oxford, 2011, p. 82

[100] J Clark, D Kane, K Wilding and P Bass, *The UK Civil Society Almanac 2012*, National Council for Voluntary Organisations, London, 2012

[101] The NCVO describes the 'voluntary sector' as those organisations which meet the 'general charities' definition. Namely, they are registered charities but are not controlled by government, non-departmental government bodies, independent (fee-paying) schools, faith groups (whose main objective is the promotion of religion), housing associations and trade associations.

[102] Social Enterprise UK, *Fight back Britain*: *A report on the state of social enterprise survey 2011*, Social Enterprise UK, London 2011

funding for the social economy. And other financing instruments (particularly debt) are paid off from this source of income. It overlaps in some areas with government procurement practices and the respective long-term contracts. This field is a quasi-market in which SEOs compete for these contracts. While social welfare has a fairly long tradition in Germany, government procurement from SEOs is a relatively new field; nevertheless, together, these two areas constitute the single-largest and also most dependable and thus important source of income funding for SEOs.

Other income-generating types of organisations are hybrids, such as fair-trade organisations; they are registered as profit-oriented businesses, because trading in Germany is a field of activity in which no non-profit legal form may be employed. Nevertheless, their self-conception is very often more or less purely non-profit, and they rely entirely on earned income – as a registered for-profit they have to, and they even have to generate at least some minimum profits. Another type of earned income is that of foundations: they invest their endowment in the financial markets to generate returns; this is also to be categorised as earned income. A nascent trend here is mission-related investment. So, overall earned income from economic activities plays a major role in the German social economy in a multitude of different forms and combinations.

In Denmark, based on the fact that many of the social services are operated by either not-for-profit companies or for-profits, there is an on-going flow of earned income finance of their innovation activities. The trend goes towards scaling to a level where real business models become possible so that both market based and earned income finance become viable. It remains to be seen whether this can be extended into more areas beyond clean energy/environmental technology, but examples from the care sector and from education give reason for cautious optimism.
In Portugal, earned income has not been as important as in the UK or Germany, but it is gaining importance. However, the income earning activities of SEOs are often limited (e.g. they work for people who cannot pay the full price of the services they get and private donations do not cover these costs). So overall, earned income is among the central funding sources and will gain importance as government support decreases, yet in total it is not as important and diversified as in other countries.

In Poland and Greece, earned income is still of minor (but also growing) importance.

Grants
Similar to income, grant finance is also not a traditional investment instrument, because grant providers do not have a financial return expectation – yet the term 'investment' does imply a rationale with a certain monetary return expectation. Although grant providers may and usually do have a certain expectation concerning a social return, the nature of the grant excludes the possibility of a financial return. Nevertheless, although they are not regarded as 'investments' in a narrow sense (in a broader sense, they may be and frequently actually are regarded as *social* investments when and as far as a social return is expected, see above), grants are important instruments for financing SEOs. That is, they constitute one of the most often used and important vehicles for 'investors' to promote the social economy.[103] Particularly regarding social innovation, this mode of *generating capital flows* should not, therefore, be neglected.

In the UK, grants and donations are the second most important source of income for the voluntary sector.[104] These were worth £14.1 billion (39% of total voluntary sector income) in 2009/10.[105] In

[103] Salamon, L.. et al. 1999: Global Civil Society… bitte nachtragen; Venturesome, *Financing Civil Society – A practitioner's view of the UK social investment market*, Charities Aid Foundation, London, 2008
[104] The NCVO describes the 'voluntary sector' as those organisations which meet the 'general charities' definition. Namely, they are registered charities but are not controlled by government, non-departmental government bodies,

terms of social enterprise, the State of Social Enterprise Survey 2011 found that the most common type of external finance applied for was a development grant (61%).[106]

A growing form of grant-making is venture philanthropy in which the investor not only provides money to the investee but also advice and access to specialist expertise. The UK venture philanthropy industry is worth more than £1.5bn and provides more than £50m in support for non-profits. But despite its rapid growth over the last 10 years, venture philanthropy still remains a small proportion of total grant-making.[107]

Also in Germany, donations are a very important source of finance to the social economy. Annually, between 4 and 6bn Euros are donated; in 2011, Germans donated €4.26bn;[108] according to another study, as much as €6bn was donated in 2011.[109] In these figures, however, a large proportion of donations is intended for humanitarian aid in the aftermath of major catastrophes. Humanitarian aid makes up for 75-80% with the remainder being donated for culture/monument preservation (7.5%), animal welfare (5.2%), environment (3.7%) and other purposes (9.4%). We do not know how much humanitarian aid goes to foreign catastrophe countries and is thus not available to domestic SEO purposes.

Public grants are also an important source of finance to the German social economy. There is a variety of support schemes and programmes for which SEOs can qualify to varying degrees. For many of these schemes, the quasi-public bank KfW acts as an intermediary.[110] However, the variety and complexity of the funding mechanisms and channels is beyond the scope of this overview.

In Greece, charitable grants have a longstanding history within the social economy. Such grants are distinguished in two main categories: grants from foundations and donations which come from people in the framework of specific philanthropic campaigns (e.g. tele-marathons which are a common form of crowd funding). A notable example of the first category is the Stavros S. Niarchos Foundation which is an international philanthropic organisation that supports charitable activities in four primary areas: arts and culture, education, health and medicine, and social welfare. The Foundation makes grants to not-for-profit organisations in Greece and throughout the world. Foundation grants include, as appropriate, funds for operating and programme support as well as funds for select capital projects and endowments. As already set out above, the most important social investor in Greece is the government. Thus, the basic source of financing for the majority of the social economy institutions are national grants from the Greek state and co-financed EU programmes.

In Denmark, grants and donations make up roughly 5% of the social economy's funding. The big foundations in the country are often linked as owners or charitable units of some of the countries larger companies. Examples are foundations of NOVO, LEGO, Carlsberg, Velux, Maersk, RealDania

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independent (fee-paying) schools, faith groups (whose main objective is the promotion of religion), housing associations and trade associations.

105 J Clark, D Kane, K Wilding and P Bass, *The UK Civil Society Almanac 2012*, National Council for Voluntary Organisations, London, 2012

106 Social Enterprise UK, *Fight back Britain*: *A report on the state of social enterprise survey 2011*, Social Enterprise UK, London 2011

107 Viewed 13 July 2012, http://www.philanthropyuk.org/news/2011-02-10/new-research-maps-uk-venture-philanthropy-revealing-huge-growth-funds

108 http://www.spendenrat.de/filearchive/51f5cc7df589a49c7a7e07dcc149b13d.pdf

109 http://www.handelsblatt.com/panorama/aus-aller-welt/milliarden-fuer-hilfsprojekte-deutsche-sind-nach-wie-vor-sehr-spendabel/7017314.html

110 http://www.kfw.de/kfw/en/Domestic_Promotion/index.jsp

etc. The total annual grants have been growing significantly over the latest decade. Some of them are highly focused on donation areas that might be less relevant to social innovation (Novo almost exclusively medical research; Carlsberg on arts and science). Others have a very high orientation towards areas of social innovation such as Lego's dedication to children's learning or Velux's concern with social equality and integration.

In Portugal and Poland, public and private grants are the major sources of social finance. It is not yet an established practice among social investors in Portugal to finance with the purpose of getting a financial return. Normally, public funds are matching grants where the investee has to come up with some percentage of the total investment cost. The way each organisation manages to obtain these matching funds varies from case to case. Some do it by appealing to their own savings. Most do it through fund raising activities. Agricultural cooperatives and other organisations based on commercial activities appeal to commercial banks, including the agricultural credit bank. Also, the preferred financing instruments used by these foundations are grants, most of which are allocated on a non-competitive basis.

Loans

For the UK, NCVO estimates the total value of loan finance to voluntary organisations to be £3.8bn[111], whilst the State of Social Enterprise Survey 2011 found that loans were the second most common form of finance applied for by social enterprises (25%).[112] In the UK, social economy organisations tend to prefer unsecured loans because few have significant assets to secure against.[113] Even though there are some social banks and social investment funds that provide unsecured lending, the bulk of lending from social banks is secured lending; over four-fifths of investment activity from social banks is currently secured lending.[114]

Another common request from social economy organisations is for patient capital. Patient capital is a loan with soft terms (typically low or no interest rates) and over longer periods (usually more than 5 years). It may also include repayment 'holidays' where capital and interest repayments are not due until the project is profitable. This type of capital is in limited supply and does not tend to come from banks (either social banks or commercial banks) but from social investment funds and charities.

As mentioned above, it is not just banks that give loans – there are several examples of social finance intermediaries giving loans on 'soft' terms, i.e. below commercial rates. For instance, the loan portfolio of members of the Community Development Finance Association was £714m in 2011 (over 200% greater than in 2006).[115] Other examples of intermediaries providing loans in the UK include the Tudor Trust, NESTA, Esmée Fairbairn Foundation and Social Investment Business. Loans through government funds are only intended to be used where bank loans cannot be secured. The logic is to use public money to finance investments with higher risk.[116]

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[111] J Clark, D Kane, K Wilding and P Bass, *The UK Civil Society Almanac 2012*, National Council for Voluntary Organisations, London, 2012

[112] Social Enterprise UK*, Fight back Britain*: *A report on the state of social enterprise survey 2011, Social Enterprise UK, London* 2011

[113] Venturesome, *Financing Civil Society – A practitioner's view of the UK social investment market*, Charities Aid Foundation, London, 2008

[114] A Brown, W Norman, *Lighting the touchpaper. Growing the Market for Social Investment in England*, Boston Consulting Group and the Young Foundation, London, 2011

[115] Community Development Finance Association, *Inside Community Finance: Annual survey of CDFIs in the UK*, CDFA, London, 2012

[116] Clearly So, *Investor Perspectives* on *Social* Enterprise *Financing*, City of London Corporation, London, 2011

In Germany, most of the economy – both social and commercial – is financed by commercial banks with regular bank loans. Yet, due to rather strict credit regulation[117] and the implications for non-profit or not-for-profit organisations, large parts of the social economy are excluded from "regular" finance – which is where other investors may step in. Largely similar to the UK, there are a number of social banks in Germany who provide loans to SEOs that face difficulties securing mainstream finance. For social entrepreneurs, a recent study showed that 13.3% rely on loan finance. For more mature and established organisations, this figure can be reasonably estimated substantially higher. Due to the overall importance of mature free welfare organisations and the fact that they are usually organised in large association networks with "their own" bank (Bank für Sozialwirtschaft[118]), loan finance in Germany is of major importance. Indeed, this bank was founded in 1923 to provide free social welfare organisations with inexpensive credit.

Both in Poland and in Portugal, loan finance is of minor importance. In Poland, a pilot scheme for a loan of 30mn PLN is scheduled to start in September 2012. In Portugal, there are no such concrete plans, but there is however, one bank, which is a mutual ("Montepio Geral") and provides loans to all sectors in the economy. In Denmark, bank loans make up roughly 1% of social investment, while in Greece, bank loans are even less important to the social economy.

Equity

In the UK as in all TEPSIE partner countries, the use of equity finance by the social economy is very limited.[119] If a social economy organisation's legal structure allows it (i.e. a company limited by shares), it can sell its shares to individuals or institutions. However, most mission driven organisations cannot have shareholders by law because they are trusts, associations or limited by guarantee (see UK social economy case study for more information). As such, equity investments are generally rare.[120]

There are some rare instances of social enterprise equity deals. For example Water Power Enterprises (h2oPE) has secured £200,000 of pre-development capital for its low-head hydro electric schemes. The investment was ground-breaking because community interest companies (CICs) are a legal form whose assets are 'locked in' for the public benefit and which have a cap on the level of any dividends. It was only made possible following the relaxation of the cap on dividends by the CIC regulator in 2010.[121]

Public share issues are another way of raising capital. Between 1984 and 2007, the total amount raised through public share issues by ethical businesses was £50.1 million.[122] Despite some high profile initial public offerings in recent years such as Café Direct in 2004 and the Ethical Property Company in 2006, the public equity market remains small. As more social economy organisations become investment ready with share capital to sell, the market is likely to develop.[123]

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[117] Everling, Oliver and My Linh Trieu (2007): ‚Rating', in: Achleitner, Ann-Christin, Pöllath, Reinhard and Erwin Stahl (2007): Finanzierung von Sozialunternehmern: Konzepte zur finanziellen Unterstützung von Social Entrepreneurs, Stuttgart: Schäfer-Pöschel.

[118] http://www.sozialbank.de/anteilseigner/

[119] Bank of England, *The Financing of Social Enterprises: A Special Report by the Bank of England*, Park Communications Limited, London, 2003

[120] Viewed 12 July 2012, http://knowhownonprofit.org/funding/social-investment-1/investment-types/equity-investment

[121] http://www.socialenterpriselive.com/section/social-investment/money/20110808/groundbreaking-%C2%A3200k-equity-deal-hydro-electric-community-i

[122] J Hartzell, *Creating An Ethical Stock Exchange*, Skoll Centre for Social Entrepreneurship, Oxford, 2007

[123] Venturesome, *Financing Civil Society – A practitioner's view of the UK social investment market*, Charities Aid Foundation, London, 2008

Community shares are also a form of equity investment. Shareholders invest in social enterprises providing goods and services that meet local needs in their local community for a modest return on their investment. Withdrawable share capital is unique to co-operatives and community benefit societies. The proportion of these organisations using their structure to raise share capital from the public is only 2%. However, since 2009, the 32 societies that have completed their offers have raised over £5.74m from 6,164 members. And if the current growth rate is maintained, it is forecast that there will be over 750 societies with community shares by 2015.[124]

Another important development is quasi-equity, also known as revenue participation investment. Quasi equity aims to fill the gap between debt and equity; it is usually structured as an investment where the financial return is calculated as a percentage of the organisation's future revenue.[125] In terms of social investment (the provision and use of finance to generate both social and financial returns), only 5% of investments made in 2010 were categorised as equity or quasi-equity.[126] However, this is potentially an important instrument for mission driven organisations and we expect this instrument to grow in importance in the future.

In Germany, there are only a handful of investment trusts that target the social economy. However, environmental protection and renewable energy are two investment sectors where there are numerous and quite substantial investment trusts. Since the mid-1990s trusts have become one of the most important equity investment vehicles; already in 2007, there were more than 20 Billion Euros invested in this instrument,[127] and in line with other social investment vehicles it should have grown substantially since then. In this respect, bilateral investment agreements may gain importance in the coming years, because they are currently being set up by the KfW. As an example, we may look at its programme[128] to support the scaling of social entrepreneurs: here, the KfW invests the same amount of debt or equity as a co-investor such as a foundation, business angel or other type of investor.

In Poland, it is difficult to define the role of equity finance and establish whether it may already have gained some importance, because currently we do not have any empirical evidence. Equity finance is not in use at a relevant scale in Denmark (except in the area of energy and climate change mitigation), Portugal or Greece.

Tax Breaks

Tax breaks for investors could be considered a social finance instrument since they play an important role in the promotion of investment flows. In the UK, the system of charitable tax relief was worth £3.5 billion in 2010/11. Just over £2.6 billion of this was claimed by voluntary organisations, through tax repayments, national non-domestic rates, VAT and stamp duty/land tax. Gift Aid is the most widely known scheme whereby the value of donations to charities is increased

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[124] J Brown, *The practitioners' guide to community shares*, Co-operatives UK and Locality, Manchester 2011

[125] Venturesome, *Quasi-Equity: Case study in using Revenue Participation Agreements*, Charities Aid Foundation, London, 2008

[126] A Brown, W Norman, *Lighting the touchpaper. Growing the Market for Social Investment in England*, Boston Consulting Group and the Young Foundation, London, 2011

[127] Heller, Peter (2007): 'Finanzierung durch offene und geschlossene Fonds', in: Achleitner, Ann-Christin, Pöllath, Reinhard and Erwin Stahl (2007): Finanzierung von Sozialunternehmern: Konzepte zur finanziellen Unterstützung von Social Entrepreneurs, Stuttgart: Schäfer-Pöschel.

[128]

http://www.kfw.de/kfw/de/Inlandsfoerderung/Programmuebersicht/Finanzierung_von_Sozialunternehmen/index.jsp by allowing them to reclaim basic rate tax on gifts.[129] Heaney and Hill argue that the current range of UK enterprise incentive schemes is poorly suited to the legal forms most commonly adopted by social enterprises. Although tax reliefs are available for equity investment, many social entrepreneurs choose legal forms limited by guarantee, which do not allow the issuing of equity. As a result many social enterprises are unable to access potential sources of growth capital.[130] Heaney and Hill criticise the Community Investment Tax Relief (CITR) scheme, set up under the Finance Act 2002 and aimed at community development finance institutions (CDFIs), for being complex and overly restrictive. They suggest a new tax incentive scheme offering relief for equity and quasi-equity investments in CICs and the widening of criteria for CIC status to include hybrid commercial businesses with a protected social mission.[131] Lloyd and Fletcher have called for a tax break to be introduced for social investment generally and CICs specifically to level the investment playing field and encourage more social venture start-ups.[132]

Tax breaks are also important in Germany. They are in place in at least two different forms: first, legally registered charitable organisations are exempted from a number of taxes (corporate taxes, industrial tax and where they undertake economic activities, a proportion of sales tax); thus it depends on the legal status of an SEO whether or not it is eligible to gain from tax breaks. In the second case, this depends on its legally accredited right to collect donations. If the organisation is accredited appropriately, the donor may deduct the donations from his/her own income tax. So these tax deductions result indirectly in income either by reducing tax burdens or increasing incomes through donations.

In Denmark, taxation takes effect on social service provision and innovation as well. Contributors to certain types of foundations are eligible for tax deductions; EVs are eligible for tax exemption; and there are tax deductions for certain kinds of energy retrofitting of buildings.

As mentioned above, in Poland 1% of income tax of individuals is channelled to mission-driven organisations which in total amounts to a relatively significant budget to the social economy.[133] In Greece, the tax environment is not as favourable. SEOs' tax treatment is actually viewed as one of the most challenging barriers to the social economy.

Microfinance/Microcredit

In the UK, microfinance has grown significantly over the past decade with major investment banks now involved in raising and structuring finance for microfinance organisations (although this tends to be for a non-UK context) – Dexia, Deutsche Bank, RBSG, Triodos and others have well established Microfinance funds.[134]

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[129] J Clark, D Kane, K Wilding and P Bass, *The UK Civil Society Almanac 2012*, National Council for Voluntary Organisations, London, 2012

[130] V Heaney & K Hill, *Investing in Social Enterprise: the role of tax incentives*, Centre for the Study of Financial Innovation, London, 2010

[131] V Heaney & K Hill, *Investing in Social Enterprise: the role of tax incentives*, Centre for the Study of Financial Innovation, London, 2010

[132] S Lloyd & L Fletcher, *Ten reforms to grow the social investment market*, Bates Wells & Braithwaite, London, 2012

[133] Hadzi-Miceva, K. and N. Bullain (2007) 'A Supportive Financing Framework for Social Economy Organisations', In: http://www.oecd.org/cfe/leedprogrammelocaleconomicandemploymentdevelopment/thesocialeconomybuildinginclusiveeconomies.htm

[134] Social Investment Task Force, *Social Investment Ten Years On: Final report of the Social Investment Task Force*, SITF, London, 2010

Microfinance in the UK is more commonly referred to as the community development finance sector which is made up of community development finance institutions (CDFIs). While some CDFIs specialise in microfinance loans, they can adopt a range of different operating structures, products and target groups to address financial exclusion and to channel finance to deprived communities.[135] CDFIs focus on the markets that banks find hard to reach: start-ups, sole traders, informal and unincorporated ventures. Between 2004 and 2011, CDFIs provided loans to 3,100 charities and social enterprises. In 2010 CDFIs lent £145m to 390 civil society organisations.[136] There is no dedicated microfinance bank in the UK.[137]

Microcredit has not really taken off yet in Portugal, although there have been some developments, in particular, the establishment of the Associação Nacional de Direito ao Crédito[138] which was set up to promote microcredit in Portugal. The main task of this organisation is to reduce the asymmetric information problems that prevent potential microcredit applicants from gaining access to commercial finance. ANDC works with these individuals to help them develop and then pitch their business plans to commercial banks with which ANDC has an agreement. As part of this agreement, the commercial bank agrees to finance the projects approved by ANDC, at the interest rate and other financial conditions defined in that agreement and without asking for collateral. Once the credit is approved ANDC monitors the utilisation of the money. Most of the operating costs of ANDC are supported by public funds.

In Germany, Greece, Poland and Denmark, micro credit and micro loans remain very small areas of interest. Especially in Germany, small amounts of finance are currently available from other public and commercial sources.

Crowdfunding

Crowdfunding involves a 'large' number of individuals providing finance, often via the internet, to one distinct activity (a cause, business or project) within a given time scale. This can take the form of a donation, loan or investment. Crowdfunding has grown rapidly in the past few years in Germany and the UK as a result of advancements in technology and social media.

In the UK, projects with a creative or social focus, where non-financial rewards are offered in return for donations, have been the most successful at raising this type of finance.[139] Donation platforms have had a significant impact on individual charitable giving. In March 2012, JustGiving announced that £1billion has been raised through the website for UK charities in the last ten years.[140] The growing importance of crowdfunding platforms in the UK was emphasised when they received 18%

[135] Viewed 17 July 2012, http://www.philanthropyuk.org/publications/guide-giving/how-give/microfinance

[136] Community Development Finance Association, *Inside Community Finance: Annual survey of CDFIs in the UK*, CDFA, London, 2012

[137] H Kraemer-Eis, A Conforti, *Microfinance* in Europe, a *market overview*, Working Paper 2009/0001, European Investment Fund, Luxembourg, 2009

[138] "Associação Nacional de Direito ao Crédito (ANDC) is a not-for-profit microcredit association created in 1998. It aims to give excluded persons the possibility to create their own business through obtaining a microcredit. ANDC does not grant loans directly since this is not permitted by Portuguese law. Instead**,** it has agreements with three different banks: Millennium bcp, CGD – Caixa Geral de Depósitos and BES – Banco Espírito Santo. These banks disburse the microloans. In addition to the arrangement with these banks, ANDC also has an agreement with IEFP, a public institute specialised in employment and professional training. As an association, ANDC today has around 300 members who contribute to a guarantee fund on top of their obligatory contributions. Members participate voluntarily in the activities of the association in areas such as corporate bodies, credit committees, legal support, monitoring and mobilisation of microentrepreneurs' promotion, and administrative support." http://www.european-microfinance.org/membres_en.php?piId=89

[139] L Collins, Y Pierrakis, *The Venture Crowd: Crowdfunding equity investment into business*, NESTA, London, 2012

[140] Viewed 18 July 2012, http://blog.justgiving.com/community/1-billion-raised-through-justgiving/

of the first funding round from the Innovation in Giving Fund. Buzzbnk and Solar Schools received £50,000 each and Peoplefund.it received £148,000.[141] In its first year of operation, Buzzbnk helped raise over £330,000 for 33 socially-minded projects.[142] Another example of a new platform is Abundance which allows individuals to invest directly in UK renewable energy projects, starting from as little as £5. Their return is based directly on the money made from making and selling green electricity.[143]

There are also platforms that are not explicitly geared towards social ventures but could potentially be generating capital flows for social innovation. For example, WeFund aims to transform arts funding by enabling anyone to feature a project they would like to undertake, and anyone to act as a patron. In addition, Spacehive is a crowdfunding platform with a focus on neighbourhood improvement projects.[144]

Although we are currently still lacking reliable data for Germany, in our qualitative judgement, crowdfunding is becoming increasingly important, particularly for funding start-up/experimental (social) entrepreneurs; a particular form is 'pledging'[145] which may also be promising for social innovations.

In Greece, despite the fact that it is not comparable to state funding or even the resources from foundations, crowdfunding nevertheless ranks among the more important finance instruments for the social economy.

Even though crowdfunding remains highly marginal in Portugal, it is considered to be a potential future source of financing for social economy organisations.

Other Instruments and Vehicles
There is a vast number of alternative and/or new instruments in use in TEPSIE partner countries. At this point in time, the following collection of these instruments cannot claim to be comprehensive. But it provides a first glimpse at how diverse and innovative the social investment field is already and how much potential it has for development through further diversification and specialisation. None of the following instruments are used widely, nonetheless, they have the potential to deliver substantial benefits for social innovation once they are better known, adopted, and disseminated.

Charitable bonds
Charities and social enterprises can issue bonds as a form of long-term debt if they have a viable underlying source of revenue. While in the UK and Germany, this form of finance is currently in early evolving stages in the social sector, it is even more uncommon in other countries. Investment in charitable bonds is largely limited to charitable trusts and philanthropic investors. In the future it is hoped that there will be a growing number of bond products available with well-established track records, which will allow more widespread investment from the general public.[146] Investing For Good is assisting Scope to become one of the first UK charities to enter the capital markets. It is piloting a £20 million bond programme operating similarly to corporate bond products.[147] Another

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[141] Viewed 12 July 2012, http://www.guardian.co.uk/voluntary-sector-network/2012/apr/02/crowdfunding-quick-fix-fundraisers
[142] HM Government, *Growing the Social Investment Market: Progress update*, HM Government, London, 2012
[143] Viewed 26 July 2012, https://www.abundancegeneration.com/about/
[144] http://spacehive.com/ viewed on 25th September 2012
[145] http://www.de.pledgebank.com/
[146] Viewed 13 July 2012, http://www.bbc.co.uk/news/business-16267298
[147] For more information see - http://www.scope.org.uk/news/scope-launches-%C2%A320-million-bond-programme

example is the series of bonds issued by Allia.[148] These generate up-front donations for charities and give back the original investment plus an optional financial return to investors. The money invested in the bonds is used to fund a loan to Places for People Homes, a registered provider of social housing. The repayment of the loan plus compound interest after five years enables Allia to repay bondholders on maturity. After the loan has been made and Allia's fees deducted, the remainder of the funds raised are given as donations to the charities selected by investors. Up until September 2011, £7.4m had been invested in Allia bonds, which raised around £1.3m for charity.[149]

Bilateral Investment Agreements

In Germany, the UK, and Portugal, bilateral investment agreements and matching funds are also emerging as a new "instrument" or vehicle for social finance. For example, the KfW bank group's programme[150] supports the scaling up of social enterprises. Under these agreements, the KfW invests the same amount of debt or equity as a co-investor such as a foundation or a business angel.

Reduced-Interest Loans

Interest subsidies may take a variety of forms and be financed by all kinds of investors, mainly the state or public bodies. For instance, in Germany the state subsidises the renovation of buildings for energy efficiency through a KfW programme: if the owner meets defined criteria concerning energy efficiency when renovating the building, the KfW will support the renovation by providing loans on LIBOR level or just slightly higher and in some cases also a significant repayment allowance.

Social Impact Bonds

Social Impact Bonds (SIBs) are a new financial instrument which have been pioneered in the UK. They are effectively a derivative (and not a bond as the name would suggest) in which the public sector agrees to pay for improvements in social outcomes for a selected group. This prospective income can then be used to raise capital from commercial, public or social investors which is used to pay for interventions. Financial returns to investors are made by the public sector on the basis of improved outcomes.

SIBs make up only a very small part of the social investment market. To date only one SIB has been fully established (aiming to prevent re-offending in Peterborough) with an investment of £5million.[151] The six year SIB pilot scheme in a Peterborough prison aims to reduce re-offending by prison leavers. If re-offending drops by more than 7.5% within six years, investors will receive a payment representing a proportion of the cost of re-offending.

The Department for Work and Pensions (DWP) has commissioned six SIBs, through the Innovation Fund, to improve employment outcomes for young people. There are several other SIBs in development. For example, Essex County Council is exploring a SIB to improve outcomes for children at risk of being taken into care and Manchester City Council has committed to piloting a similar SIB. Age UK and Improving Care are developing a SIB on ageing and care in Cornwall. The

[148] Viewed 24 July 2012, http://www.allia.org.uk/investing/
[149] S Hedley & I Joy, *Review of Allia's charitable bonds*, New Philanthropy Capital, London, 2011
[150] http://www.kfw.de/kfw/de/Inlandsfoerderung/Programmuebersicht/Finanzierung_von_Sozialunternehmen/index.jsp
[151] E Disley, J Rubin, E Scraggs, N Burrowes & D Culley, *Lessons learned from the planning and early implementation of the Social Impact Bond at HMP Peterborough*. Ministry of Justice, London, 2011

Greater London Authority is also working with the Department for Communities and Local Government (DCLG) to set up a SIB on rough sleeping in the capital.[152]

There is a lot of hype surrounding SIBs but a number of questions remain open: where SIBs could be most useful, how they should be structured, and whether they will actually work. In the near term, SIB investors are likely to be charitable foundations or philanthropists who prioritise societal benefit over financial rewards.[153]

New Currencies and Time Banking

There is not a longstanding history of alternative currencies in the UK. The Brixton pound (B£), launched in 2009, was the UK's first local currency in an urban area. Similar to German local currencies, it is designed to support local businesses and encourage local trade. Around 180 businesses accept B£s with £30,000 in circulation (mainly confined to Brixton). London Mutual Credit Union (incorporating Lambeth and Southwark) became the official B£ 'bank' in April, offering issuing and exchange functions and holding the sterling reserve to be used to enhance their capital base and make ethical, low interest loans.[154]

Time banking can also be considered a form of alternative currency where value is tracked and exchanged outside of the mainstream economy. There are different models of time banking; some are person to person, or 'peer-to-peer'. Timebanking UK, the national umbrella organisation for time banking, is now well established and there are several examples of different time banking models being tested in a variety of settings. For example, SPICE has developed a person to agency model of time banking in South Wales which has spread around the UK.[155]

In our view, alternative currencies are not of major importance as a source of finance for social economy organisations but they may be considered social innovations in their own right.

Prizes and Challenge Funds

Prizes and public challenges can be an effective means of distributing funds and incentivising innovation. They can involve several different actors trying to deal with 'joined up' problems or needs. One UK example is the National Health Service (NHS) Innovation Challenge Prizes which are awarded in recognition of significant breakthroughs relating to major health challenges.[156] Another is InnovateNoW which offers funding to NHS staff members or organisations within the North West of England who would like to implement an idea or spread an innovation across the healthcare system in the region. Funding ranging from £5000 to £250 000 is provided through three different awards schemes.[157] A third example is the Big Green Challenge, a £1 million social challenge prize for community-led solutions to climate change. Launched in 2007, it engaged over 300 communities and over 1500 people in developing innovations at a local level, working within their local area to reduce carbon emissions.[158] Other examples include the Santander Social Enterprise Development Awards (SEDA) and the Social Enterprise Awards (England, Northern Ireland, Scotland and Wales). The National Endowment for Science, Technology and the Arts (NESTA) is currently

[152] HM Government, *Growing the Social Investment Market: Progress update*, HM Government, London, 2012
[153] Social Finance, *A New Tool for Scaling Impact: How Social Impact Bonds Can Mobilize Private Capital to Advance Social Good*, Social Finance, Boston, 2012
[154] D Boyle, *Platforms for exchange and reciprocity in public services,* NESTA, London, 2011
[155] Viewed 24 July 2012, http://www.justaddspice.org/
[156] Viewed 17 July 2012, http://www.biginnovationsapply.institute.nhs.uk/
[157] Viewed 26 July 2012, http://www.innovatenow.org.uk/
[158] L Bunt, 'Social Innovation Challenge Prizes: More Than Just The Money', *Social Space*, pp.106-110, 2011

establishing the UK Centre for Challenge Prizes and the UK Innovation Prize Fund. The Centre will run, design and facilitate inducement prizes in areas where innovation is needed.

In Portugal, Prizes have two main sources: public/governmental and private (e.g., foundations, universities and commercial banks). Most of these prizes reward innovation and social innovation but some also function as seed-capital for social economy organisations to get started.

In Germany, the state is very keen on promoting innovation through prizes and challenge funds. Traditionally, these prizes have concentrated on technological and business innovation. However, promoting innovation directly though prizes is quite difficult and as such, the state tends to reward innovation 'post factum' by awarding innovation prizes both on federal, regional, and community levels. In recent years, prizes for social innovation and the social economy have been increasingly emphasised.[159]

Standby Facilities and Overdrafts
In the UK, standby facilities are used to allow organisations to commit to projects when their income is lumpy or before their fund raising efforts are complete. They usually take the form of a loan, where money can be drawn down over a certain period of time when it is needed. Interest is only charged on the funds drawn down. Overdrafts typically underpin cash flow requirements and are available from commercial banks and specialist lenders. An overdraft does not have to be borrowed in one lump sum and interest is usually paid on the amount of money that is borrowed until it is repaid. According to Venturesome, standby facilities and overdrafts are frequently used as a safety net.[160] We do not have data on the monetary volume of standby facilities and overdrafts to social economy organisations.

Deficiency/Default Guarantees
In Germany, the state also supports some industries (and even non- profit organisations, such as development organisations) through deficiency guarantees: if an export or a project in a foreign country is not adequately compensated for as agreed by the parties, the state may cover (some of) the loss, i.e. risk is reduced and/or return expectations improved for the investor and thus overall investment is incentivised.

Peer-to-Peer Lending Networks
Peer-to-peer lending or investing involves financial transactions directly between individuals or "peers" without the intermediation of a traditional financial institution. Zopa was the first peer-to-peer lending network in the UK. As of July 2012, around £200,000 had been lent via Zopa.[161]

4.2.2. Investors

Different investor types are important to different kinds of organisations. So, foundations are more important to grant funded charities than social investment funds, however, social investment funds play a critical role in helping some social enterprises grow and scale impact. Also, we need to draw a distinction between social investors, who provide the funds, and social investors, who distribute the funds. Social investment finance intermediaries (SIFIs) tend to distribute funds and are

[159] E.g. "social city" prize (awarded by one of the large welfare organisations, the "Arbeiterwohlfahrt") or "social service provision" prizes: http://www.consozial.de/index.php?section=237
[160] Venturesome, *Financing Civil Society – A practitioner's view of the UK social investment market*, Charities Aid Foundation, London, 2008
[161] http://uk.zopa.com/

important – but they are not always the ones who provide the capital. In the UK, the arrival of Big Society Capital will change the landscape significantly over the coming years.

Also, in some partner countries, notably Germany and the UK, there is some anecdotal evidence that mainstream banks also play a significant role in funding mission-driven organisations – usually secured loans and bridging loans. However, this role is not very visible – there are almost no figures on the number of mission driven organisations securing investment from mainstream commercial financial institutions or the amount that these institutions have lent to mission-driven organisations. In this respect, it is also important to mention that many mission-driven organisations face difficulties in accessing mainstream, commercial finance.[162] Although most of the economy – both social and commercial – is financed by commercial banks with regular bank loans, due to rather strict credit regulation[163] (such as Basel II), large parts of the social economy are excluded from "regular" finance. And besides this, there are significant financing gaps, since most investors' focus lies on either start-up/founding phase or mature organisations. Investing in the scaling and growth of SEOs is not an attractive proposition to most investors as a result of the balance between risks (based on large capital requirements in relation to start-ups) and potential returns (based on unpredictable future returns in relation to mature organisations). This is why the social investment market has been developed over the last decade in the UK and to various degrees in other countries, too.

The State

The state collects taxes and finances numerous activities, among them social economy efforts and investments; but in some TEPSIE partner countries, the state also collects various other funds from wage-earners that are not taxes and are connected to and result in certain *rights* for the payers (pension, social security, nursing insurance, etc.). In both cases, the state is the central actor in the overall financing landscape. The state's role is highly diverse as it plays a major role in the overall financing landscape. It:

- Commissions goods and services (funds mission driven organisations directly), which is particularly important in the UK where many types of services that are provided by the state directly in other countries are commissioned from SEOs;
- Funds mission driven organisations (through local authorities, through departmental budgets and funds, by funding the Social Investment Business or the KfW Bank, etc.);
- Sets up intermediaries that fund mission driven organisations (e.g. BLF, UnLtd, NESTA etc. in the UK or the German KfW Bank) and/or offer interest-subsidised loans;
- Uses tax breaks to incentivise investment;
- In some countries, such as Germany or the UK, the state runs major lotteries (or has them run by quasi-public institutions). The proceeds from surpluses are used for social purposes.

In the UK, the government has played a key role in shaping and growing what has become Europe's most developed and advanced social investment market. First – by setting up the Social Investment Task Force in 2000 but also by establishing a range of organisations (BLF, UnLtd and Social Investment Business, Big Society Capital etc.) which play a key role in resourcing mission driven organisations. The Big Society Capital survey found that central government was the largest source

[162] Bank of England, The Financing of Social Enterprises: A Special Report by the Bank of England, London, Bank of England, 2003

[163] Everling, Oliver and My Linh Trieu (2007): ‚Rating', in: Achleitner, Ann-Christin, Pöllath, Reinhard and Erwin Stahl (2007): Finanzierung von Sozialunternehmern: Konzepte zur finanziellen Unterstützung von Social Entrepreneurs, Stuttgart: Schäfer-Pöschel.

of social investment funds in 2010/11 (50-60% of the total). Government has such a dominant role due to funds such as Futurebuilders and the Social Enterprise Investment Fund (SEIF) – managed by The Social Investment Business Group.[164]

One of the most significant contributions in developing the field was the establishment of the Social Investment Task Force in 2000 which was tasked with examining how "entrepreneurial practices can be applied to obtain higher social and financial returns from social investment, to harness new talents and skills to address economic regeneration and to unleash new sources of private and institutional investment. In addition, the Task Force should explore innovative roles that the voluntary sector, businesses and Government could play as partners in this area."[165] The Task Force made the following recommendations:

- *To introduce a Community Investment Tax Relief (CITC)*: The CITC, introduced in 2002, was intended to: "encourage private investment in under-invested communities, via Community Development Finance Institutions (CDFIs) which can invest in both not-for-profit and profit-seeking enterprises… CITR provides 5% tax offset each year over a five-year period (25% over the term) to investors providing funds to accredited CDFIs that then finance qualifying enterprises and community projects in underinvested communities. To achieve accreditation, CDFIs must meet certain criteria regarding their geographic area of operation and the financial products they offer investors…. The number of CDFIs accredited for CITR has grown from eleven on its launch to more than twenty today. CITR has attracted £58 million to March 2009 (the latest point for which data is available) against the £200 million target set by the SITF and the Government. The main reason for the shortfall is the restrictive nature of the criteria imposed by the Government on use of the facility."[166]
- *To set up Community Development Venture Funds*: The Social Investment Task Force recommended the creation of Community Development Venture Funds (CDV Funds) in order to apply the "successful principles of venture capital, namely long term equity investment, business support to the entrepreneur and rapid growth of the company backed" to community investment. The government provided £20m in matched funding to set up the first CDV Fund in the UK – Bridges Ventures. Bridges Ventures is a private mission driven investment firm which is majority owned and managed by its executive directors and the Bridges Charitable Trust. It continues to receive support from the three private equity firms (Apax Partners, 3i and Doughty Hanson) that helped to set it up in 2002. It has set up a number of funds:
    - Bridges Ventures Fund I (£40m) – launched in 2002, invested in businesses in the most deprived 25% of England and aimed "to create role models of entrepreneurship, jobs and economic dynamism".[167]
    - Bridges Ventures Fund II (£75m) - launched in 2007, was raised entirely from the private sector with a similar focus to the first fund.
    - Bridges Social Entrepreneurs Fund – launched in 2009, aimed to "fill the gap often faced by fast growing social enterprises looking to scale. Almost £12m has been

[164] These figures should be treated as indicative. Also, note that this excludes the provision of grants, donations or other funds which have no expectation of paying back. A Brown, W Norman, *Lighting the touchpaper. Growing the Market for Social Investment in England*, Boston Consulting Group and the Young Foundation, London, 2011
[165] Social Investment Task Force, Enterprising Communities: wealth beyond welfare, A 2003 update on the Social Investment Task Force, London, CDFA, 2003
[166] Social Investment Task Force*, Social Investment Ten Years On: Final report of the Social Investment Task Force*, SITF, London, 2010
[167] Viewed on 26th July 2012 http://www.bridgesventures.com/about-us

raised so far from The Office for Civil Society and a mix of leading financial institutions, individuals and foundations."

- Bridges Sustainable Property Fund – launched in 2009, "this £28m fund invests in properties in regeneration areas and environmentally sustainable buildings that have potential to make strong financial returns as well as delivering social and environmental impact."
- Care Places Fund – launched in 2011, is a partnership with Castleoak Group has raised £32m. The Fund will invest in care home developments supplied by Castleoak.
- Bridges Ventures Fund III – launched in 2011 with £72m. As with the first two funds, this fund will focus on "provision of growth capital to small and medium sized businesses in sectors where underlying social or environmental need creates the opportunity for both commercial returns and positive impacts".

So far, Bridges Ventures has invested £72m in 35 companies, including £63m in 33 companies in underserved areas.[168] The government also provided funding for other regional CDV Funds; key players here include: WHEB Ventures, CAF/Venturesome, Big Issue's Big Invest and Triodos Social Enterprise Fund.

- *Disclosure by banks of their lending in under-invested communities*: The SITF called for "more detailed information about the lending pattern of individual banks, as is available in the US, makes it possible to compare good and bad practice and encourage a cumulative 'improvement in performance'. If voluntary disclosure is not made quickly, the Social Investment Task Force believes that Government should require disclosure, in the manner of the 1977 US Community Reinvestment Act." Even though some banks have provided information, voluntary disclosure on the whole has not been successful and the sector as a whole does not disclose information about lending which means that meaningful analysis and comparisons are difficult to make.[169]
- *Greater latitude and encouragement for charitable trusts and foundations to invest in community development*: In response to the SITF's report, the Charity Commission issued new guidance on social investment in 2001. The Commission stated that any charity that gives grants can make social investments as long as this investment furthers the charity's mission. There have since been a range of publications which examine the ways in which grant giving charities can make social investments.[170] In 2000 there were hardly any charities providing capital investments (other than grants) to mission driven organisations. There is now a far greater range of options open to grant making charities – loans, quasi-equity etc. as well as mission connected investment and venture philanthropy (discussed below). While there are still relatively few charities involved in social investment this is a growing and important trend.
- *Support for Community Development Finance Institutions (CDFIs)*: The Community

[168] Bridges Ventures, *2011 Impact Report: innovative investments that make a difference*, London, Bridges Ventures 2011
[169] Social Investment Task Force*, Social Investment Ten Years On: Final report of the Social Investment Task Force*, SITF, London, 2010
[170] The Magic Roundabout: How charities can make their money go further; an introductory guide to Programme Related Investment (May 2003). Foundations and Social Investment – making money work harder in order to achieve more (October 2005). Mission Possible – emerging opportunities for mission connected investment (May 2008). Financing Civil Society: A Practitioner's Guide to the Social Investment Market (September 2008) and Access to Capital: A briefing paper (September 2009).

Development Finance Association (CDFA) was established by the Treasury in 2002. It has since "become a well respected trade body, representing to central and regional government the majority of the UK's CDFIs and facilitating their growth. By 31st March 2009, CDFIs had an aggregated loan book of nearly £400 million, had created and sustained 96,000 jobs and attracted £500 million of private sector funding into UK businesses and households underserved by mainstream financial institutions."[171]

According to the NSTSO, 14% of third sector organisations (23,000) in the UK regarded statutory funding as their most important source of income.[172] For just over one in ten voluntary organisations (11%), statutory bodies are the majority provider of their income.[173] There has been significant debate in the UK about the over-dependence of organisations on state funding, but NCVO analysis suggests that only 10,500 (6% of the voluntary sector) received the majority of their income from statutory contracts and 5,900 received the majority of their income from statutory grants. The proportion of income from statutory sources in 2009/10 by size of voluntary sector organisation is as follows: micro – 5%; small – 21%; medium – 35%; large – 38%; major – 41%. The small and micro organisations that make up the vast majority of the sector are less reliant upon government funding whilst income from government contracts and grants is more important for organisations above the £100,000 threshold.[174] So, the bigger the organisation, the more likely they are to be dependent on public sector funds (usually in the form of service contracts). Moreover, some areas of activity are more reliant on statutory funding than others. For example, organisations working in employment and training receive 71% of their overall income from statutory sources, compared with law and advocacy (54%), education (52%), housing (51%) and social services (51%).[175]

In terms of the social investment market, dependence on public funds is fairly high with roughly 50-60% of funds of social investment intermediaries coming from the public purse.[176]

In terms of income from contracts, the voluntary sector received £10.9 billion in 2009/10, a real increase of £6.7 billion (157%) in ten years.[177] The State of Social Enterprise Survey 2011 found that 50% of all social enterprises trade with the public sector (representing 18% of total turnover).[178]
In terms of grant funding, The State of Social Enterprise Survey 2011 found that 38% of social enterprises receive grants or core funding from public sector bodies (9% of total turnover).[179] Grant

[171] Social Investment Task Force*, Social Investment Ten Years On: Final report of the Social Investment Task Force*, SITF, London, 2010
[172] This data is taken from the 2008 National Survey of Third Sector Organisations (NSTSO).The survey gathered 48,000 responses from a representative sample of charities and other third sector organisations. The sample frame included approximately 129,000 charities, as well as 40,000 companies limited by guarantee, Industrial and Provident Societies, and Community Interest Companies (CICs). D Clifford, FG Rajme, J Mohan, *How dependent is the third sector on public funding? Evidence from the National Survey of Third Sector Organisations*, Working Paper 45, Third Sector Research Centre, Birmingham, 2010
[173] J Clark, D Kane, K Wilding and P Bass, *The UK Civil Society Almanac 2012*, National Council for Voluntary Organisations, London, 2012
[174] J Clark, D Kane, K Wilding and P Bass, *The UK Civil Society Almanac 2012*, National Council for Voluntary Organisations, London, 2012
[175] J Clark, J Dobbs, D Kane & K Wilding, *The State and the Voluntary Sector: Recent trends in Government Funding and Public Service Delivery*, NCVO, London, 2009
[176] A Brown, W Norman, *Lighting the touchpaper. Growing the Market for Social Investment in England*, Boston Consulting Group and the Young Foundation, London, 2011
[177] J Clark, D Kane, K Wilding and P Bass, *The UK Civil Society Almanac 2012*, National Council for Voluntary Organisations, London, 2012
[178] *Social Enterprise UK, Fight back Britain*: *A report on the state of social enterprise survey 2011, Social Enterprise UK, London* 2011

income from statutory sources was worth £2.9 billion to the voluntary sector in 2009/10. Between 2008/09 and 2009/10 statutory grants increased slightly by £0.2 billion (7%).[180]

The state also provides capital by setting up intermediary funds such as Futurebuilders and the Social Enterprise Investment Fund (SEIF) managed by The Social Investment Business Group.[181] New Philanthropy Capital estimates that over £350 million was invested by funds managed by SIB between 2008 and 2011. However, many of these funds are now closed, which may result in a funding gap.[182]

The British state also distributes lottery money through 13 quasi-public bodies. The most relevant to social innovation is the Big Lottery Fund (BIG) which focuses on voluntary organisations, health, education and the environment. BIG's Innovation fund is specifically about supporting new projects that test new ways of tackling emerging and existing social problems. It offers grants of between £20,000 and £1 million for projects running up to five years.[183]

Although the German social investment market is much less developed (and researched) than the UK's, the state has undertaken numerous activities. The relation between the state and the social economy is highly complex in Germany and cannot be described in detail here. Most notably, in the corporatist model prevalent in Germany, the state and public bodies are highly interrelated with the welfare economy through various channels. Here one distinction is of central importance:

- The state collects taxes and finances numerous activities, among them social investments;
- And the state also collects various other funds that are not taxes and are connected to and result in certain *rights* for the payers (pension, social security, nursing insurance, etc.), i.e. in this respect the state is an intermediary.

The fact that in both cases the state is the central actor makes up for its major role in the overall financing landscape. However, the state's role is highly diverse: some of its payments are authorised by "the taxpayer" (represented by the government's legislative and executive bodies), while other resources are appropriated funds tied to a certain use and dispersed by other actors, i.e. the ones in charge of running the respective institutions (who are, in turn, legally regulated to various degrees in terms serving their particular purpose under the German "Zuwendungsrecht"[184]). These free welfare organisations ("freie Wohlfahrtspflege") are a major part of the German social economy. They are organised in six umbrella associations, three with denominational/religious origins and missions (Catholic, Protestant, and Jewish) and three secular ones (workers, red cross, and joint welfare association), with the two clerical umbrellas being among the largest private employers worldwide. Combined, these organisations employ roughly 1m people, have another 1.2m volunteers, and generate a turnover of more than €45bn. They are financed largely through per-capita service payments.

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[179] Social Enterprise UK, *Fight back Britain*: *A report on the state of social enterprise survey 2011*, Social Enterprise UK, London, 2011

[180] J Clark, D Kane, K Wilding and P Bass, *The UK Civil Society Almanac 2012*, National Council for Voluntary Organisations, London, 2012

[181] These figures should be treated as indicative. A Brown, W Norman, *Lighting the touchpaper. Growing the Market for Social Investment in England*, Boston Consulting Group and the Young Foundation, London, 2011

[182] I Joy, L de Las Casas & B Rickey, *Understanding the demand for and supply of social finance: Research to inform the Big Society Bank*, New Philanthropy Capital, London, 2011

[183] Viewed 24 July 2012, http://www.biglotteryfund.org.uk/prog_big_innovation

[184] Birkhölzer, Karl and Ludwig Kramer (2004): ‚Grundstrukturen und Erfolgsbedingungen innovativer Arbeits- und Unternehmensformen in Sozialen Unternehmungen', in: Birkhölzer, Karl, Ernst Kistler and Gerd Mutz (Eds.): ‚Der Dritte Sektor: Partner für Wirtschaft und Arbeitsmarkt', Wiesbaden: VS Verlag.

Besides its role in the welfare system, the German state supports the overall financial flows to the social economy in a variety of ways. There are several different ways for the state to invest in the social economy.

- The single largest form of investment consists of tax breaks, exemptions and deductions. Donations are rendered applicable for tax deductions, i.e. donations are tax deductible (up to a certain amount) to qualified organisations which is a standard fundraising argument for these organisations and in sum leads to huge "additional" donations (i.e. donations that would not be made if these tax-deduction options were not offered).

- A second form of investment consists of promotion schemes, programmes and prizes. The state in Germany is quite interested in promoting innovation. But to do so directly is quite difficult. As such, the state rewards innovation post factum by awarding innovation prizes both on federal, regional, and community levels. And the state finances large parts of the university system in Germany. These are two rather indirect ways to finance and/or foster innovation undertaken by the government. To foster start-up, innovation and social economy support schemes, the state also operates the KfW bank. This bank focuses very much on promoting innovation in general, particularly economic innovation, but also social innovation by lately focussing on social entrepreneurship. The financial support is limited to 200,000 Euro per organisation for scaling.

Apart from that, the German state is supporting the social economy with the indirect objective to have innovation promoted by the actors in this sector; yet generally, it does not limit its efforts to the *social* economy, but tries to bring out and exploit innovative potential regardless from which sector the innovation emanates. Overall, this reflects the subsidiarity principle in Germany - the state aims to foster innovation in general, but it does not finance it directly or even concentrate on or pick certain organisations or sectors. It aims to provide finance via intermediaries (such as the KfW) and/or incentives (e.g. tax deductions) but does not step in with an active role in financing innovation directly.

In Poland and Greece, the most important social investor is the government. Both states are the key players in providing economic incentives and supporting SMEs. It is the basic source of financing for the majority of the social economy institutions mainly through national grants and co-financed EU programmes. In Poland, the key player in the area of social finance is among other state institutions the Ministry of Regional Development in Poland which is taking part in an implementation of the project "The network for a better future of the Social Economy" financed by a grant from the European Commission for 2009-2012.[185]

In Greece, the state has developed special funding tools and mechanisms, mainly in the form of different funding programmes, supporting all kinds of business activity such as the respective Investment Law supporting enterprises and providing incentives, the Credit Guarantee Fund for Small and Very Small Enterprises, and also various national programmes reinforcing the entrepreneurial activities of SMEs. However, SEOs are usually excluded from receiving funds from different EU programmes mainly due to the limited information on the existence of such programmes. They also face significant challenges such as the lack of knowledge and expertise in: drafting proposals; a lack of management experience; a lack of experience in modern funding methods and tools; and business planning and strategy.[186]

[185] European Union, Editors SB Serrano, G Hahn & G Pastorelli, 'A Better Future: Results of the Network Better Future of Social Economy', Brussels.

[186] National thematic Network on Social Economy, 'Proposal for generating a framework on the institutional, administrative and financial support of initiatives undertaken in the field of Social Economy in Greece', Community Initiative EQUAL, 2006.

In Portugal, the private social welfare organisations, or the so-called IPSSs ("Instituições Particulares de Solidariedade Social"), are the only group of social economy organisations which can benefit from a scheme of public support ("Protocolos de Cooperação" - Cooperation Agreements) with the following characteristics:

- It covers part of their operating costs;
- It is updated on a regular basis through negotiations between the three national confederations representing the IPSSs (CNIS - The National Confederation of Social Solidarity Organisations, The Union of "Misericórdias" and the Union of the Mutuals) and the Ministry of Social Solidarity;
- It is not dependent on EU funds.

The amount of state funding for these kinds of "Cooperation Agreements" is more than €1.2bn per year. For the state financial support to investment costs, the private social welfare organisations, as well as the other social economy organisations have to apply to special programmes (some co-funded by the EU), if and when they are available which have a limited duration and specific eligibility conditions (see 3.2.3.)

The European Union

Although the European Union may be seen as part of the 'public sector', it should be given additional emphasis here, because it plays a major role in resourcing the social economy and social innovation in Greece, Poland and Portugal. The main instruments set up and used by the European Union are the European Social Fund (ESF) and the European Regional Development Fund (ERDF), and the Cohesion fund. Most of their efforts and investments are generally concentrated in general economic development, but they do also target social objectives. For instance, the ESF EQUAL programme invested € 3.2bn in innovative projects across the Union in the period from 2000-2006. Another example is the EU progress Microfinance Facility, a fund with a commitment of €100 million from the PROGRESS Programme and a further €100 million from the European investment bank (EIB) and plans to disburse €50m a year until 2015. In terms of social innovation, the ERDF is of central importance, mainly via the '4 J' programmes:

- JASMINE: Joint Action to Support Micro-finance Institutions in Europe
- JASPERS: Joint Assistance in Supporting Projects in European Regions;
- JEREMIE: Joint European Resources for Micro to Medium Enterprises;
- JESSICA: Joint European Support for Sustainable Investment in City Areas.[187]

Although these are obviously large and important programmes, we have so far not been able to determine the exact extent to which they take effect in the social economies of Greece, Poland and Portugal. However, we do have anecdotal evidence from these partner countries which is provided at the appropriate points in this report and will be of continuous interest in the coming WP4 tasks.

Social banks

In Germany and the UK, social banks are regulated and operate in the same way as mainstream banks but their lending is restricted to organisations delivering predominantly social and environmental benefit. Their business model is similar to mainstream banks in that they aim to attract deposits from customers and then invest these funds for a predictable return. Social banks

[187] C O' Sullivan, S, Tucker, P, Ramsden, G, Mulgan, W, Norman & D, Vascancelos, 'Strengthening Social Innovation in Europe: Funding and Financing', Draft, December 2011

are therefore interested in relatively low-risk, long-term investments which skews the current social investment market towards safer asset classes.[188]

In Britain, the Big Society Capital survey found that social banks were the second largest source of social investment funds (finance to generate both social and financial returns) in 2010/11 - 25-30% of the total. The market is currently dominated by four social banks (Charity Bank, Ecology Building Society, Triodos UK and Unity Trust Bank) that collectively account for about 70% of social investments made in 2010/11. However, these figures exclude investments which do not generate financial returns such as grants.[189] Although offering unsecured loans differentiates social investors from mainstream banks, over four-fifths of investment activity from social banks is currently secured lending.[190] Loans offered by social banks average between £50,000 and £400,000.

In Germany, there are five major social banking institutions, four of them private (Triodos Bank, GLS Bank, EthikBank, UmweltBank) and one owned largely by the free welfare umbrella associations (Bank für Sozialwirtschaft). Assets under management of the four private ones have increased 20-30% annually in the years from 2006 to 2011. However, their total private banking market share is merely 0.2% and their total customer base 230,000 as of the end of 2011.

However, more and more conventional banking institutions are adopting the socio-ecological banking model at least in part due to its vast success as expressed in the development of these four "pioneers'". In addition, we can assume that besides private banking, there are large quasi-markets in which free welfare organisations and other social economy actors secure loan investment. In this respect, it important to point out that social banking has quite a long tradition in Germany. Back in 1923, the Bank für Sozialwirtschaft was founded by social economy organisations. These organisations are nowadays among the largest employers worldwide, and thus their role in the German social economy is significant. So, although bank's balance sheet and outstanding loans are relatively small (€6.3 and €3.9 respectively), it does play a significant role in the overall financing of the social economy – and it illustrates that social banking is not so much of a new phenomenon.

In Greece, Poland and Portugal, social banks in the sense of banks specialising in the social economy sector do not exist. There is a bank in Portugal whose legal status is a mutual ("Montepio Geral"), but it does business with all sectors of the economy.

Commercial banks

In Germany and the UK, commercial banks play a significant role in social finance – however that role is not very visible and is hard to quantify. And as aforementioned, many mission driven organisations face difficulties in accessing commercial finance.[191] Particularly in the UK and partly as a response to the state initiatives outlined above, mainstream banks have recently started to increase their engagement in providing finance to organisations generating social impact. Under

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[188] A Brown, W Norman, *Lighting the touchpaper. Growing the Market for Social Investment in England*, Boston Consulting Group and the Young Foundation, London, 2011; Dohmen, Caspar (2011): 'GOOD BANK: Das Modell der GLS Bank', Freiburg: orange press.

[189] These figures should be treated as indicative. Also, note that this excludes the provision of grants, donations or other funds which have no expectation of paying back. A Brown, W Norman, *Lighting the touchpaper. Growing the Market for Social Investment in England*, Boston Consulting Group and the Young Foundation, London, 2011

[190] A Brown, W Norman, *Lighting the touchpaper. Growing the Market for Social Investment in England*, Boston Consulting Group and the Young Foundation, London, 2011

[191] Bank of England, The Financing of Social Enterprises: A Special Report by the Bank of England, London, Bank of England, 2003; Everling, Oliver and My Linh Trieu (2007): ‚Rating', in: Achleitner, Ann-Christin, Pöllath, Reinhard and Erwin Stahl (2007): Finanzierung von Sozialunternehmern: Konzepte zur finanziellen Unterstützung von Social Entrepreneurs, Stuttgart: Schäfer-Pöschel.

Project Merlin, Barclays, HSBC, Lloyds Banking Group and RBS have agreed to invest equity of £50m each in Big Society Capital. They made this commitment in the context of wider discussions (known as the 'Merlin' agreement) with the Government on 'increasing their positive contribution to society and to economic recovery' as part of the bail out in 2008-2009. UK mainstream banks are also increasingly seeking to improve their knowledge of the voluntary and social enterprise sectors. This has led to the creation of specialist charity and social enterprise departments[192] e.g. Barclays Community Finance Fund, Royal Bank of Scotland Community Business Loan Fund.

One interesting development (although we do not yet know what this might mean for social innovation or social investment) is the recent deal between the Co-operative Bank and the Lloyds Banking Group. The Co-operative Bank will take over 632 Lloyds TSB and Cheltenham and Gloucester branches. Roughly 5 million Lloyd customers will transfer to the Co-op, together with 7,000 staff. This deal (which is expected to be finalised in November 2013) will take the Co-operative's presence to about 1,000 branches (or, 10% of the UK's entire branch network).[193]

Concerning banks in Germany, it is important to draw a distinction between savings banks, co-operative banks and private banks. First are savings banks ("Sparkassen") which are quasi-public institutions with the legally regulated primary goal of providing the public with financial products (savings accounts and loans with fair conditions) and not allowed to make a profit (which is why they frequently become philanthropic investors and donate surpluses). Then, there are co-operative banks ("Genossenschaftsbanken") which are less regulated but are also not primarily driven by profit motives but by the goal to serve their members. Finally, there are publicly traded banking corporations and other private banks fully driven by profit motives. Of course, the social economy is financed primarily through the first two types. However, we are currently still analysing the landscape for data here. Overall, all three types operate more or less like regular market actors, i.e. they can be distinguished from social banks on the basis of their business model and strategies.

In Portugal, commercial banks also appear in the list of social investors (although being of much lower importance than the government) because of the role played by the non-governmental organisation, ANDC (Associação Nacional de Direito ao Crédito).[194] This NGO was set up to promote microcredit in Portugal. The main task of this organisation is to reduce the asymmetric information problems that prevent potential microcredit applicants from gaining access to commercial banks. ANDC works with these individuals to develop their business plans and pitch them to three commercial banks with which ANDC has an agreement, namely, Millennium bcp, CGD Caixa Geral de Depósitos and BES Banco Espírito Santo. Under this agreement the bank accepts to fund the projects approved by ANDC who provides some form of collateral. Once the credit is approved ANDC monitors the utilisation of the money. Most of the operating costs of ANDC are supported by public funds.

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[192] JPA Europe Limited, *Social Enterprise and the Social Investment Market in the UK: An Initial Overview*, JPA Europe Limited, London, 2010

[193] See http://www.guardian.co.uk/money/2012/jul/19/co-op-lloyds-bank-takeover

[194] "Associação Nacional de Direito ao Crédito (ANDC) is a not-for-profit microcredit association created in 1998. It aims to give excluded persons the possibility to create their own business through obtaining a microcredit. ANDC does not grant loans directly since this is not permitted by Portuguese law. Instead**,** it has agreements with three different banks: Millennium bcp, CGD – Caixa Geral de Depósitos and BES – Banco Espírito Santo. These banks disburse the microloans. In addition to the arrangement with these banks, ANDC also has an agreement with IEFP, a public institute specialised in employment and professional training. As an association, ANDC today has around 300 members who contribute to a guarantee fund on top of their obligatory contributions. Members participate voluntarily in the activities of the association in areas such as corporate bodies, credit committees, legal support, monitoring and mobilisation of micro entrepreneurs' promotion, and administrative support." http://www.european-microfinance.org/membres_en.php?piId=89

Commercial banking institutions do not play a significant role in social finance in Greece or Poland. Yet in both countries, social enterprises are largely faced with exclusion from the banking system due to the reasons already outlined for the UK and Germany. Yet these reasons weigh even more heavily there, particularly in Greece as a result of the economic crisis.

Businesses

Corporate giving can take the form of cash donations, payroll giving, matching employees' donations, in-kind support, employee fundraising, secondments and volunteering. Given the lack of consensus in definitions of corporate giving, it is difficult to measure.

In the UK, the total value of corporate support to the voluntary sector is estimated to be around £1.55 billion annually (£800 million from different forms of sponsorship and £750 million from grants and gifts). This represents less than 5% of total voluntary sector income.[195] The top corporate givers are healthcare and pharmaceutical companies. However, if the large product donations of these companies were excluded, it would be the financial and mining sectors.[196] It is estimated that cash giving makes up around two-thirds (67%) of total corporate support to UK charities, with the rest being in-kind giving.[197] However, there has been a shift away from cash donations to in-kind giving over the last few years.

There are also examples of prize competitions to promote social innovation set up by corporations:

- Deloitte Social Innovation Pioneers – a programme of support to help 30 selected socially innovative businesses;[198]
- McKinsey Innovate - a social enterprise competition for UK students with the winners receiving seed funding and ongoing support;[199]
- British Innovation Gateway (BIG) Awards - part of a Cisco-led programme to support hi-tech business and innovation.[200]

In Germany, the involvement of business with the state and the social economy is quite complex. In the corporatist German model, business has traditionally been supposed to assume the role of a partner in the overall social system ("Sozialpartner") which links it to the state and to society as a whole in a variety of ways. Important examples for the social economy include the fact that businesses are co-responsible for employing disabled people and for job education. However, the role of business as a contributor to civil society and to the social economy has become more of a voluntary responsibility which is somehow "expected" but less institutionalised than it used to be 50 years ago.[201] Nevertheless, private businesses do contribute vast sums of resources to the social economy. Most visible is corporate sponsoring, e.g. sponsorship of large events or sports teams, particularly football. A relatively new and emerging trend is cause-related marketing. Although

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[195] J Clark, D Kane, K Wilding and P Bass, *The UK Civil Society Almanac 2012*, National Council for Voluntary Organisations, London, 2012

[196] C Walker, C Pharoah, M Marmolejo & D Lillya, *UK corporate citizenship in the 21st century*, Briefing Note 9, CGAP, London, 2012

[197] C Walker, C Pharoah, M Marmolejo & D Lillya, *UK corporate citizenship in the 21st century*, Briefing Note 9, CGAP, London, 2012

[198] Viewed 18 July 2012, http://www.deloitte.com/view/en_GB/uk/about/community-investment/social-innovation/index.htm

[199] Viewed 18 July 2012, http://www.innovate2012.mckinsey.com/

[200] Viewed 18 July 2012, https://www.thebigawards.co.uk/Page/Home

[201] Backhaus-Maul, H. (2007): ‚Traditionspfad mit Entwicklungspotenzial', in: Backhaus-Maul, H., Biedermann, C., Nährlich, S., Polterauer, J. (Eds.): Corporate Citizenship in Deutschland: Gesellschaftliches Engagement von Unternehmen. Bilanz und Perspektiven. Wiebaden: VS Verlag.

detailed data on the overall amount of money flowing to the social economy is not available, it can be said that German businesses are generally quite engaged. A large-scale survey revealed in 2006 that 95.6% of German corporations and SMEs are active in voluntary civic engagement – beyond sponsoring activities.[202] Of these businesses, the majority are engaged through corporate giving, with 83.4% donating money and 59.7% giving in-kind donations.

In Greece, funding from private companies is developing rapidly during the last years mainly through the implementation of their CSR programmes. Prominent examples are Vodafone, Cosmote and Carrefour-Marinopoulos super markets.[203]

SRI Funds

Socially Responsible Investment (SRI) is the incorporation of social, ethical and or environmental factors into the process of selecting, retaining and realising investments. It can include:

- Negative screening – excluding certain investment propositions based on social and/or environmental criteria e.g. tobacco companies;
- Shareholder advocacy – involves shareholders taking an active role through dialogue and resolutions;
- Community investing – directs capital from investors and lenders to communities that are underserved by traditional financial services institutions.

Over the last decade there has been a huge growth in SRI. Research conducted by the UKSIF estimates Assets under Management in the UK as £938.9 billion (as of 31st December 2009), representing a 19% increase compared with 2007.[204] However – in the UK as with elsewhere – it is not clear that there is a link between SRI and investing in mission driven organisations. Because SRI funds invest in listed companies[205] and there aren't many mission driven organisations that are listed, it is not clear how SRI helps to capitalise mission driven organisations. The new Social Stock Exchange which is currently in development may be an exciting development in this space.

From the German perspective, SRI is also becoming increasingly important. Although its share of the overall investment fund market is marginal (1-2%), SRI is growing quite substantially and continually. As of April 2012, there were roughly 360 SRI funds in Germany, Austria, and Switzerland combined. The reasons for the marginal role of SRI in the overall investment market may be found in Germany's investment culture which has traditionally focused on forms of investment usually not covered by SRI vehicles, such as life insurance and fixed-interest investment. As a result, SRI investment products have only been offered by a limited number of small institutions with a fairly limited customer base and reach.[206]

SRI funds do not yet play a significant role in Poland, Greece or Portugal.

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[202] Braun, S. (2010): ‚Zwischen nationalen Traditionen…' In: Braun, S. (Ed.): ‚Gesellschaftliches Engagement von Unternehmen: Der deutsche Weg im internationalen Kontext'

[203] http://www.carrefour.gr/inside.aspx?a_id=189

[204] Robeco and Booz and Company, *Responsible Investing: A Paradigm Shift – from Niche to Mainstream*, Robeco and Booz and Company, 2008

[205] Heller, Peter (2007): 'Finanzierung durch offene und geschlossene Fonds', in: Achleitner, Ann-Christin, Pöllath, Reinhard and Erwin Stahl (2007): Finanzierung von Sozialunternehmern: Konzepte zur finanziellen Unterstützung von Social Entrepreneurs, Stuttgart: Schäfer-Pöschel.

[206] http://www.green-economy.de/oekologisch-investieren/social-responsibile-investments/glossar/sri-in-deutschland.xhtml
http://www.nachhaltiges-investment.org/News/Marktberichte.aspx

Foundations

Foundations are important or even key players in social finance in all TEPSIE partner countries. Some give funds to any charitable purpose, whilst others are restricted to specific subjects or beneficiary groups (often this is reflected in the organisation's name). Foundations may take very diverse forms and engage actively in the social economy (operative foundations) or rather passively as grant-makers. Recently, the issue of mission-related investment (see below) has emerged as a critical area of debate among UK and German foundations. Advocates are increasingly calling upon foundations to invest some of their endowments in organisations and/or ventures that are related to and promote their social missions.

There are 11,700 trusts and foundations that give grants in the UK (within this group a relatively small number of large grant-makers dominate).[207] The majority of grant making charities focus on giving grants; very few are engaged in social investment (i.e. are seeking a blend of social and financial returns). Far more information is needed among trustees and charity staff for charities to engage in Programme Related Investment (PRI) and/or Mission Connected Investment (MCI). However, some foundations are now experimenting with investment funds. The Big Society Capital survey found that trusts and foundations were the third biggest source of social investment funds (finance to generate both social and financial returns) in 2010/11 (under 5% of the total).[208] Examples include the Esmée Fairbairn Foundation, the Lankelly Chase Foundation, NESTA, the Barrow Cadbury Trust and the Tudor Trust. More importantly, "the endowment funds themselves are not currently invested in the social investment market due to concerns about poor returns and illiquidity of investments." [209] The Esmée Fairbairn Foundation, one of the largest grant making organisations in the UK, set up a £21m social investment fund in 2008 to provide money as loans, quasi-equity and other forms of returnable finance. As of April 2012, 48 investments had been made, representing £8m of funds drawn and another £8m in commitments. The investments include direct investments to charities and social enterprises as well as indirect investments made via intermediaries such as Bridges Ventures and Big Issue Invest.[210] The National Endowment for Science, Technology and the Arts (NESTA) is a leading investor in innovation in the UK which makes investments in social ventures that address three major social needs: an ageing population, the learning and employability needs of young people and the sustainability of communities. Over the last three years, NESTA has deployed £5m to build a portfolio of investments into social venture intermediaries and SIFIs.[211] The Lankelly Chase Foundation is using £5m of its capital endowment (roughly 5%) to establish a Social Investment Fund. The intention is to make investments at a rate of approximately £1m a year and potentially increase the Social Investment Fund by a further £5m at a later date. To date the Foundation has made 8 social investments at a total of £1.7m.[212] The Tudor Trust has also committed to invest endowment assets in an increasingly mission-related manner in addition to traditional grant-giving activity.[213]

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[207] J Clark, D Kane, K Wilding and P Bass, *The UK Civil Society Almanac 2012*, National Council for Voluntary Organisations, London, 2012
[208] A Brown, W Norman, *Lighting the touchpaper. Growing the Market for Social Investment in England*, Boston Consulting Group and the Young Foundation, London, 2011
[209] A Brown, W Norman, *Lighting the touchpaper. Growing the Market for Social Investment in England*, Boston Consulting Group and the Young Foundation, London, 2011
[210] Viewed 26 July 2012, http://esmeefairbairn.org.uk/what-we-fund/finance-fund/
[211] Viewed 27 July 2012, http://www.nesta.org.uk/investment/impact_investments/current_portfolio
[212] Viewed 25 July 2012, http://www.lankellychase.org.uk/our_work/social_investment
[213] Social Investment Task Force*, Social Investment Ten Years On: Final report of the Social Investment Task Force*, SITF, London, 2010

The German foundation field is also very large and complex. There are no exact figures on the overall number of foundations in Germany, but more than 18,000 are registered legal entities. The field is dominated by some large players, and much of this activity remains largely unnoticed by the public. Even though they form and integral part of the social investment field, this role is hard to quantify. Although foundations are not per se social economy organisations or social investors in Germany, less than 5% of foundations pursue commercial objectives.[214]

In the German context, it is important to distinguish between funding and operative foundations: funding foundations may be viewed as social investors, while operative foundations should be seen more as innovators and therefore as investees (Stiftung Liebenau) which can and often do have and/or generate their incomes and budgets on their own (i.e. without external investment requirements). Operative foundations (Bertelsmann, Bosch, Vodafone, Liebenau) are among the most important actors in the German social economy in terms of innovation. Some of the largest foundations in Germany promote social innovation in a very focused, goal-oriented and also resource-intensive way.[215] The Mercator and Vodafone Foundations promote social entrepreneurship.[216]

However, it cannot be said that foundations as an investor type generally focus on social innovation – to a certain extent, many of them do, but not all are concerned with it in such an explicit and targeted way. In this respect we also need to point out that foundations are very open to co-operating with partners to work towards common innovation goals, i.e. very often they are incubators of innovative projects in which they tie together resources, bundle diverse partners' strengths and coordinate their efforts. So when it comes to social innovation, foundations are one of the most important actors beyond the provision of financial resources.

In Portugal, besides the State the most prominent type of social investor are private foundations funded by corporate income, mainly Fundação Calouste Gulbenkian (which has a large endowment from the oil industry), Fundação EDP (the foundation of the major power company in Portugal), Fundação Manuel António da Mota (the foundation of one of the major construction companies in Portugal), and – possibly the most important one – Fundação Montepio (related to Montepio Geral). This foundation does not provide funding in the pure financial sense of the word, like the bank to which it is affiliated. Rather, it provides financial support to the projects of social economy organisations, which otherwise would have difficulties in continuing projects by themselves. In some cases, instead of giving money for the projects or the organisations, the foundation gives support in kind, for example, it buys and donates vehicles to SEOs. In Portugal, this kind of activity to support SEOs and projects is not exclusive to "Fundação Montepio". Other foundations or other kinds of organisations do this too, or even more than "Fundação Montepio".

Also in Greece, foundations play a major role in the field of social finance. Traditionally, Greek philanthropic organisations or cultural foundations enhance social economy activities through donations, grants and other supporting activities. The most prominent example is the Stavros Niarchos Foundation which has given nearly $1.3b through grants to various non profit organisations.[217] During the last two years and other significant activities, the foundation has

[214] Bundesverband Deutscher Stiftungen (Ed.) (2011): 'Verzeichnis Deutscher Stiftungen', Berlin.
[215] E.g., the SEIS project of Bertelsmann Foundation aimed at lifting schools' self-improvement potential by providing them with an effective self-evaluation tool http://www.bertelsmann-stiftung.de/cps/rde/xchg/SID-FB301BC5-5BBBF319/bst_engl/hs.xsl/5278.htm
[216] Mercator: http://www.stiftung-mercator.de/en/news/news/message-details/article/stiftung-mercator-founds-first-national-research-network-dedicated-to-social-entrepreneurship.html?CDFS=&cHash=0306c33f615427d462af98938a88042f
Vodafone: http://en.vodafone-stiftung.de/content/social_entrepreneurship/index.html
[217] http://www.snf.org/index.php?ID=snfs_EN

introduced two new initiatives. In November 2011, SNF provided €1.5m in grants for a series of pilot programmes to address social issues. In January 2012, the board of directors committed a further €100m over the next three years to ease the adverse social effects of the ever-deepening economic crisis in Greece.[218]

Impact Investors
A number of UK investment banks are starting to engage in impact investing. For example, Deutsche Bank launched an Impact Investment Fund in 2011. This acts as a wholesaler, and the fund "provides finance to social enterprises via intermediaries with the aim of generating both positive social impact and a financial return, as well as seeking to play a role in encouraging and developing the social finance market. Deutsche Bank is the first investment bank to create a discrete, ring-fenced fund to invest in this nascent asset class, which complements our Corporate Social Responsibility (CSR) activities in the UK."219 The fund will be a maximum of £10m, to be invested between 2011 and 2014 and repaid over 10 years. However, it is fairly problematic to categorise banks as impact investors, because these new initiatives are often developments in CSR rather than a change to the bank's core business. It is also worth noting that some impact investors face a significant dilemma: they have considerable amounts of capital but no outlets of sufficient scale to invest in.[220]

Private Equity/Venture Capital Investors

Generally, private equity and venture capital are not among the primary funding sources for the social economy. However, these investors have traditionally focused on innovation. Therefore, there is a cross-section in the field of renewable energy and green technology. Here we can speak of social investment to a certain degree. In Germany, Denmark, and the UK, VC and private equity have traditionally been among the most important investors in this respect.

Here again, the UK government plays a progressive role: Venture Capital Trusts (VCT) are a tax incentive scheme designed to encourage individuals to invest directly in a range of small higher-risk trading companies whose shares and securities are not listed on a recognised stock exchange.[221] However, Heaney and Hill argue that the UK VCT scheme is not well suited to social enterprise.[222] This is because the restrictions of VCT are too great; VCT funds have to deploy funds within a given timeframe and hold investments for a minimum period of time which adds significant pressures and may force the fund to exclude suitable investment opportunities. Second, some VCT investors will not be eligible for tax relief, or may prefer a different tax structure. VCT relief is aimed at retail investors, while the emerging social VC funds are often targeting institutional investors, foundations and charities – which may not enjoy the same tax relief as individuals. Also, according to Heaney and Hill, "the necessary market infrastructure to find and channel…retail flows into social VC funds has not been developed".

This having been said, however, Heaney and Hill argue that social venture capital is an emerging part of the VC market. Three funds have been established to date - the Triodos Social Enterprise Fund (although this was closed soon after opening because they failed to find sufficient investible

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[218] http://www.philanthropy-management.com/news/Impact/Greece__a_third_sector_response.aspx
[219] Viewed 25 July 2012,
https://www.db.com/unitedkingdom/content/en/deutsche_bank_impact_investment_fund_1.html
[220] S. Godeke and P. Pomares, 'Solutions for Impact Investors: From Strategy to Implementation', 2009.
[221] http://www.hmrc.gov.uk/guidance/vct.htm
[222] V Heaney & K Hill, *Investing in Social Enterprise: the role of tax incentives*, Centre for the Study of Financial Innovation, London, 2010

social enterprises), the Bridges Social Entrepreneurs Fund and Big Issue Invest - but none of these funds has been structured as a VCT – largely as a result of the difficulties mentioned above.[223] There are also examples in the UK of VCTs which list social enterprise among their targeted sectors, such as Triple Point Investment, but no VCTs specifically invest in social enterprise.[224]

There are also examples of private equity funds backing venture philanthropy initiatives such as Impetus and the Breakthrough programme of CAN and Permira.[225] Here, we see the cross-sections both between social/commercial finance and between the "regular" and the social economy. There is a similar situation in environmental and renewable energy sectors, venture capital and private equity have been quite important over the last 15-20 years. However, investments of VC trusts targeted primarily large projects and corporations (so there is a close relation to SRI investment funds). What is (becoming) more important to German social economy organisations are open-ended special funds investing in young organisations with high innovative and growth potential.[226] In Poland, Portugal and Greece, VC investors are of minor importance to the social economy.

Angel Investors

Angel investors are high net worth individuals (HNWIs) who invest on their own or as part of a syndicate. They typically invest between €10,000 and €1,000,000. Even though there are well-established business angel networks in Germany and the UK, with networks including Addidi Pioneers and Go Beyond in Britain and the BAND[227] in Germany, there are very few angel networks that specifically target the needs of social businesses and enterprises. Again however, the UK has started to take a leading role here, with Clearly Social Angels (CSA) set up by Clearly So in March 2012 as the UK's first angel network focused on social and environmental businesses.[228] Investment opportunities are sourced from Clearly So's entrepreneur network and a strategic group of deal flow partners. In the future more angel networks of this type are likely to emerge, particularly in the UK with other countries likely to follow suit. So, HNWIs could play an important role in accelerating social investment.

In Poland, Portugal and Greece, angel investors do not play a key role in social investment.

Investment Intermediaries

It should be noted that many investors also act as intermediaries. Social investment funds are an intermediary between supply and demand of social finance capital; the same is true for banks and for social banks, which connect savers and borrowers and provide the service of credit assessment and management. There are no clear lines of demarcation commonly and consistently used between TEPSIE member countries, so what counts as an intermediary in one country is often seen as an investor in another.

In the UK, the two most important intermediaries are Big Society Capital and Community Development Finance Institutions (CDFIs). The new social investment wholesale bank, Big Society

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[223] V Heaney & K Hill, *Investing in Social Enterprise: the role of tax incentives*, Centre for the Study of Financial Innovation, London, 2010
[224] V Heaney & K Hill, *Investing in Social Enterprise: the role of tax incentives*, Centre for the Study of Financial Innovation, London, 2010
[225] Social Investment Task Force*, Social Investment Ten Years On: Final report of the Social Investment Task Force*, SITF, London, 2010
[226] Heller, Peter (2007): 'Finanzierung durch offene und geschlossene Fonds', in: Achleitner, Ann-Christin, Pöllath, Reinhard and Erwin Stahl (2007): Finanzierung von Sozialunternehmern: Konzepte zur finanziellen Unterstützung von Social Entrepreneurs, Stuttgart: Schäfer-Pöschel.
[227] Business Angels Deutschland; http://www.business-angels.de
[228] Viewed 26 July 2012, http://www.clearlyso.com/investors/CSA.html

Capital (BSC), is of particular relevance. BSC is a new financial institution that will provide £600m of new capital to the social sector and is intended to help develop and grow a sustainable market for social investment in the UK. Even though BSC was only launched in April 2012, it has been in development for years. The idea was first proposed 5 years ago when the Commission for Unclaimed Assets reported that the social sector was in critical need of greater investment and professional support and that capital from dormant bank and building society accounts should be used to fund a 'Social Investment Bank'. The Commission called for this bank to be a wholesaler of capital; that is, provide capital to Social Investment Finance Intermediaries (SIFIs) rather than social enterprises or voluntary sector organisations directly. BSC was fully authorised by the Financial Services Authority in March 2012 and BSC was formally launched the following month. Big Society Capital is funded from a combination of £400m of unclaimed assets (dormant for over 15 years) and £200m of investment from four high street banks - Barclays, Lloyds, HSBC and RBS – as part of the 'Project Merlin' agreement. It will not issue grants or lend directly to social enterprises, but will instead provide capital to SIFIs. It will be financially sustainable in the long term but not profit maximising.[229] Initially, the minimum size of investment made by BSC will be £500,000 and the maximum will be £15m. So far, BSC has committed to five investments in principle – the first of up to £450,000 to Think Forward Social Impact Ltd. This was established by Private Equity Foundation to support young people into education, employment and training.[230] The other four in-principle investments are in Franchising Works License Fund, Social Stock Exchange, Triodos New Horizons Fund and the Community Generation Fund and are worth approximately £8m.[231]

CDFIs are also of major importance in the UK: "CDFIs lend money to businesses, social enterprises and individuals who struggle to get finance from high street banks and loan companies. They help deprived communities by offering loans and support at an affordable rate to people who cannot access credit elsewhere. They work in the UK's most deprived and disadvantaged communities and provide a range of financial support from bridging loans, working capital, loans for fixed asset acquisitions etc."[232] The Community Development Finance Association (CDFA) was established by the Treasury in 2002. It has since "become a well respected trade body, representing to central and regional government the majority of the UK's CDFIs and facilitating their growth. By 31st March 2009, CDFIs had an aggregated loan book of nearly £400 million, had created and sustained 96,000 jobs and attracted £500 million of private sector funding into UK businesses and households underserved by mainstream financial institutions."[233]

CDFIs are also responsible for distributing the Community Investment Tax Relief. This was introduced in 2002, and was intended to: "encourage private investment in under-invested communities, via Community Development Finance Institutions (CDFIs) which can invest in both not-for-profit and profit-seeking enterprises…CITR provides 5% tax offset each year over a five-year period (25% over the term) to investors providing funds to accredited CDFIs that then finance qualifying enterprises and community projects in underinvested communities. To achieve accreditation, CDFIs must meet certain criteria regarding their geographic area of operation and the financial products they offer investors….The number of CDFIs accredited for CITR has grown from eleven on its launch to more than twenty today. CITR has attracted £58 million to March 2009

[229] Clearly So, *Investor Perspectives on Social Enterprise Financing,* Report prepared for the City of London Corporation, City Bridge Trust, and the Big Lottery Fund, London, Clearly So, 2011
[230] Viewed 28 July 2012, http://www.bigsocietycapital.com/our-story/
[231] Cabinet Office, Growing the Social Investment Market: Progress Update, London, Cabinet Office 2012
[232] The Social Investment Task Force, *Social Investment Ten Years On - Final Report of The Social Investment Task Force*, London, 2010
[233] The Social Investment Task Force, *Social Investment Ten Years On - Final Report of The Social Investment Task Force*, London, 2010

(the latest point for which data is available) against the £200 million target set by the SITF and the Government. The main reason for the shortfall is the restrictive nature of the criteria imposed by the Government on use of the facility."[234]

For Germany, the central intermediaries are summarised in the following table:

Table 4-1 – Central intermediaries, Germany

Type	Function	Example
Rating agencies	Sustainability/CSR rating	oekom Research, SAM
Rating agencies	NPO/SEO rating	Phineo
Crowdfunding and other funding platforms	Connect micro-investors with micro-lenders	See p. 58ff. here[235] - betterplace.com
Networks	Promotion, support, scholarships, collaboration, network access	Ashoka Germany, Schwab Foundation, Business Angels Netzwerk Deutschland (BAND)
Enablers and supporters	Coaching, advice, support, network access, consulting	XperRegio, IQ Consult; oursocialinnovation.org
Consulting	Research, consulting (e.g. M&A, market research)	Heldenrat (Germany) Philanthropy arms of commercial banks' private wealth management departments

The EU may also become an important investment intermediary for social finance and innovation. It plans to set up a programme under the heading of 'Proposal for a Regulation on European Social Entrepreneurship Funds' which aims to set out "a new 'European Social Entrepreneurship Fund' label, so investors can easily identify funds that focus on investing in European social businesses".[236]

Other (Types of) Investors

- A particularity of the German social economy is its welfare system and free welfare work organisations ("freie Wohlfahrtspflege") which make up a major part of the German (social) economy. They are organised in six umbrella associations, three with denominational/religious origins and missions (Catholic, Protestant, and Jewish) and three secular ones (workers, red cross, and joint welfare association), with the two clerical umbrellas being among the largest private employers worldwide. Together, these organisations employ roughly 1m people, have another 1.2m voluntary supporters, and generate a turnover of more than €45bn. They are financed largely through per-capita service payments.
- Another major "player" is private individuals and "the crowd". As we have seen in the previous section, among the most important "instruments" are the private funds of the "4Fs" (founders,

[234] The Social Investment Task Force, *Social Investment Ten Years On - Final Report of The Social Investment Task Force*, London, 2010
[235] http://www.schwabfound.org/pdf/schwabfound/SocialInvestmentManual.pdf
[236] http://ec.europa.eu/internal_market/investment/social_investment_funds_en.htm viewed Sept. 24, 2012.

family, friends and fools). However, it is difficult to understand founders, families, friends and fools as "investors" – or if we do, we cannot adequately estimate let alone measure their relative importance. However, according to a recent study,[237] there are approximately 16 million people aged over 16 (or 23.1% of the population) in Germany who are principally willing to invest (part of) their money in socially and/or ecologically sustainable investment vehicles with moderate financial returns. So there is a vast potential for social finance in the middle range of the investment continuum. It may be hypothesised that – in line with increasing technology infrastructures – a significant proportion of this "investor" group is responsible for the recent boom in crowdfunding. Nevertheless, although being an important and remarkable trend, overall crowdfunding is estimated to be far below 5% of total social economy financing.

- In most countries (except Greece), cooperatives still play a minor role in relation to other types of investors. However, their share is growing in general and particularly in social innovation.[238] In terms of renewable energy, wind turbines are resourced by co-operatives founded for this particular purpose; the same is true for solar parks or other community-based energy projects; also some innovative community housing projects have been implemented by (founding) cooperatives.[239]

4.2.3. Investees

Investees and their special characteristics are often overlooked when social finance is discussed. At first sight, social finance consists primarily of actors investing money for some social purpose. That is, *investors* and investment *instruments* are the focus, while the "social purpose" remains rather vague or is subsumed under such terms like culture or integration. And indeed, as we outlined above, social finance is definitely characterised by the fact that funds are invested for some social purpose which distinguishes it from commercial finance. Nevertheless, when the claim is made to portray or even analyse social finance thoroughly, one has to take a closer look at the receivers of the funds, because they are actually the ones who actively generate a social return, and thus they are the ultimate social investors. So, although investors and investment instruments are important constituents of social finance, its *distinctiveness* derives primarily from *investee* characteristics.

First of all, investee characteristics matter in terms of social finance because of their legal forms and the rights and responsibilities linked to them. Various legal forms have specifications about the ways in which profits and assets are shared and/or distributed. These specifications have an impact on the kind of investments that these organisations can secure. For example, charities cannot distribute profits; they must reinvest any surplus into the organisation or its mission. They cannot have shareholders and therefore cannot raise capital from equity subscriptions. Unlike charities, community interest companies (CICs) in the UK can issue shares and pay dividends to investors. One of the distinguishing features of a CIC is this ability to raise equity in order to access investment beyond traditional bank loans, grants and donations. The CIC form has been criticised on the grounds that its rates of return do not reflect risk, and that CICs are therefore unattractive to venture capital. Social businesses and social enterprises will often face difficulties accessing traditional grants as they do not have charitable status – which is often a necessary condition for grant recipients.[240] And, they often face challenges accessing mainstream finance – as already mentioned above, there is a lack of understanding among mainstream investors and lenders about

[237] http://www.zeb.de/customer/templates/media_get.php?mediaid=1299&fileid=3259&sprachid=1
[238] A recent best-practice example of social innovation by founding a co-operative is the train station co-operative in Leutkirch, Germany, nominated for one of the country's major governmental prizes (the 'Deutsch Engagementpreis'); http://www.leutkircher-buergerbahnhof.de/die-idee/die-idee.html
[239] e.g. http://www.geos-eg.de/43325.html
[240] For more information about legal forms see our case study of the UK Social Economy

the potential risks and returns that social enterprises offer.[241] In Germany and the UK, the social investment market aims to support social enterprises, charities with trading arms and socially/ethically responsible businesses that find it difficult to get grants and/or mainstream finance. So when talking about preferred finance instruments, it is important to recognise that there are often limitations about the kinds of instruments used.

Besides legal prerequisites, preferences and needs will also vary for different kinds of investees. In all TEPSIE countries, there is understandably a clear preference in terms of capital investments for grants among grant funded charities, trading charities and social enterprises. This is fairly unsurprising – however, 'cheap' money acts as a barrier to developing the social investment market and acts as a disincentive to take on and/or develop new forms and instruments of social investment. When looking at preferences or investee-specific needs, we must also take account of the difference between preferred and possible - grants are not always available and indeed over the last few years, particularly as a result of the European economic crisis, fewer grants are available. Indeed, increasing competition within the non-profit sector as costs rise and funding becomes more difficult to obtain has encouraged voluntary organisations to start trading and selling goods to diversify their income sources.[242]

So, generally social finance is distinct from traditional commercial finance, particularly because organisations/individuals *receiving* investment use it for a social purpose, i.e. they meet a social need or solve a social problem. As a result, for the description and analysis of social finance, it is paramount to take a close look at what exactly investees are and what they do: what are their social finance needs, what are their aims and motivations, and how do social investees use social investment to achieve their objectives? While these are also questions for WP2, they also need to be addressed in this paper.

In contrast to previous sections, the following will not be organised thematically, but rather, on national lines. This is necessary at this state of the research: there are currently no comprehensive or consistent accounts of social investees that could enable a consistent categorisation across all six TEPSIE countries. That is, organisations categorised in one heading in one country are often categorised differently in another. This problem has not yet been resolved and as such, we will describe each country's investees along the demarcation lines suitable for the respective countries. In many cases, however, these demarcation lines are also not clear at this point in time and at this state of research on the various countries' social economies.

Denmark

In Denmark, by far the most important type of investees are public sector institutions. The major part of social finance is allocated to them, and thus, combined they make up roughly 90% of the total finance field. In total, the Danish social finance field consists predominantly of the following types of actors:

a. Public sector institutions
b. Not-for-profit organisations with public sector operator roles
c. For-profit companies
d. Membership associations
e. Community organisations

[241] Bank of England, *The Financing of Social Enterprises: A Special Report by the Bank of England*, London, 2003
[242] K Peattie, and A Morley, *Social enterprises: Diversity and dynamics, contexts and contributions*, London: Social Enterprise Coalition and Economic and Social Research Council, 2008

The social and welfare sectors in Denmark are primarily concerned with the following main challenges:

- Inclusion, self-determination and empowerment of marginalised groups
- Integration
- Unemployment, especially youth unemployment and activities to mitigate (training; motivational programs etc.)
- A growing ageing population
- Care and service provided for people with physical and/or mental disabilities
- Childhood care and education
- Energy, environmental issues and climate change mitigation.

Of course, the lion's share of social finance therefore consists of public funds allocated to public sector institutions. So, since almost all of the capital and finance flow originates with the public sector, it is necessary to understand the financial instruments as defined by the public sector. The most common "instruments", therefore, are ongoing, often law defined annual operating budgets. Other important and often neglected forms of "instruments" are capital investments aimed at buildings, infrastructure, technology and other facilities. Tendered operational tasks and projects (public procurement) as well as development programs are also among the most frequently used and important "instruments".

In all the main focus areas there are large on-going operations of social services that try to meet identified social needs. Many of these services are operated by the public sector and virtually all of them are financed by the public sector. They are on-going service operations based on past identification of needs and past innovation to identify solutions to these needs, and they are strongly embedded in the fabric of comprehensive institutional systems. In terms of finance, the money cannot be separated from the operational costs of the system.

Germany

In Germany, the main social investees are large welfare organisations organised under six umbrella associations. The most important investee types in Germany are:

a. Free welfare organisations
b. Operative foundations (Bertelsmann, Bosch, Vodafone, Stiftung Liebenau)
c. Grant and member-fee-based non-profit organisations (Greenpeace, UNICEF, WWF)
d. Co-operatives (Greenpeace Energy, coop eG, die tageszeitung Verlagsgenossenschaft eG)
e. Social entrepreneurs, social enterprises (Dialogue in the Dark, Regionalwert AG, XperRegio)

a) Free welfare organisations

These are organised under six umbrella associations, the three largest being the Diakonie (affiliated to the Protestant churches), Caritas (Catholic church-affiliated), and Deutsches Rotes Kreuz (Red Cross). So, although they are affiliated with the state via various channels, they are fundamentally independent from the state which is why they are called *free* welfare organisations. They have a long and important tradition within the German welfare mix. Most of the German welfare organisations receive their regular income as service charges. Nevertheless, these organisations are able to secure finance from regular capital markets due to their perceived secure and longstanding position. The main financial instrument used by these organisations is bank loans. It should be noted that for welfare organisations there is one special mission-driven bank in Germany, the Bank für Sozialwirtschaft (see “Investors” section). So, when they are in need of finance, welfare organisations have “their own” bank to acquire resources from, a fact that has significant influence on the preferred financial instrument.

b) Operative foundations

Although there is no reliable data, a conservative estimate is that there are more than 1500 operative foundations and more than 1000 both funding and operative foundations in Germany. So, their combined operative engagement accounts for a significant part of the German social economy. The rationale behind the classification of operative foundations as “investees” is that they require resources for their operations – just like other social economy actors. The main difference is that they finance these operations rather autonomously – yet they do need financial resources that need to be generated. Thus their primary financial “instrument” is a special form of earned income (also see notes at I.1.2 – l). The main “instrument” of operative foundations is income earned from interest on their endowment.

c) Grant- and Donation-based Charities

Also in Germany, there are large grant-based charities among the most prominent and publicly visible parts of the social economy, mainly because of large media and billboard ad campaigns.

However, they operate under different legal frameworks (associations like Greenpeace or the German committee of UNICEF, foundations like the German WWF branch, or large-scale projects like *Brot für die Welt* do not have a legal organisational form). That makes it hard to grasp their overall financial volume. This problem is exacerbated because some of the largest organisations are affiliated with organisations falling under other categories. *Brot für die Welt*, for instance, is a project of the two major churches and their respective free welfare organisations, but also one of the largest receivers of grants from the public sector, receiving more than 80% of its €67m budget from public sources.[243] It also collects much of its budget via the church and in church services. Additional income sources for charities in Germany are allowances, fine reassignments, third-party funds and interest revenues.

d) Co-operatives

Co-operatives may be split up into five categories (credit/banking, rural, business, consumer and housing). Not all of them are mission-driven; in fact, it is hard to determine whether they are. However, in the last few years the number of co-operatives with a self-attributed social mission has risen.[244] Overall, although the number of co-operatives has declined over the last 30 years, the number of individual members has risen from 13,275 in 1980 to 20,744 in 2010; total turnover of the co-operative sector was €160m in 2010.[245] In recent years there has been a revival of co-

[243] http://www.brot-fuer-die-welt.de/downloads/presse/jahresbericht_2011.pdf
[244] Birkhölzer, Karl and Ludwig Kramer (2004): ‚Grundstrukturen und Erfolgsbedingungen innovativer Arbeits- und Unternehmensformen in Sozialen Unternehmungen’, in: Birkhölzer, Karl, Ernst Kistler and Gerd Mutz (Eds.): ‚Der Dritte Sektor: Partner für Wirtschaft und Arbeitsmarkt’, Wiesbaden: VS Verlag.
[245] http://www.corporate-portal.dzbank.de/components/getdata.php?file=1321346969DieDeutschenGenossenschaften_Auszug.pdf

operatives across Europe - even if there is little reliable data to prove this phenomenon.

e) Social enterprises/social entrepreneurs

There is a long list of criteria suggested in the literature to describe what social enterprises[246] are. The most common criteria according to Edwards[247] are:

- "Using innovative methods to address social and environmental goals that draw ideas and resources from different sectors, organizations and disciplines.
- Generating all or most of their income from commercial revenue, user fees, service contracts and equity investments (rather than foundation grants, member dues, or individual donations), but not accruing profit for personal gain.
- Engaging directly in the production and/or sale of goods and services, especially in areas like health education, social welfare, environmental sustainability, organizational development and employment training.
- Forming and governing themselves through more inclusive and democratic practices than in a normal business, with avenues for participation by users and other stakeholders and a high degree of organizational autonomy."

Currently, we are witnessing a boom in organisations with these features.[248] In Germany, many social enterprises aim to integrate the hard to employ (the disabled, ex-offenders, hard-to-place youth, etc.) into the regular labour market. The scope of social entrepreneurs is much broader but some do focus on work integration and aim to support groups which are not usually covered by the 'traditional' work integration organisations (such as particular groups of youth, e.g. migrants or females, or certain geographic areas, etc.). In some cases they also use innovative approaches to labour market integration i.e. they may be seen as the innovative "part" of the "integration industry". Both "traditional" and social entrepreneurship work integration efforts have increased significantly over the last two decades.[249] According to a recent survey, social entrepreneurs finance themselves in the following ways: 63.8% use their own private funds followed by state grants (34.2%) the 4 f's (18.8%) and bank loans (13.3%).

Greece

In Greece, there are different demarcation lines. Here, the most important social economy investees are characterised like this:

a. Associations
b. NGOs
c. Foundations

[246] Many German social enterprises are cooperatives. That fact illustrates just one of the difficulties one faces when trying to set up clear-cut categories – even more on a transnational level.
[247] M Edwards, 'Just Another Emperor? The Myths and Realities of Philanthrocapitalism', Demos, A Network for Ideas & Action and The Young Foundation, 2008, p. 17.
[248] Borzaga, Carlo and Jacques Defourny (Eds.) (2004): 'The Emergence of Social Enterprise', New York: Routledge.
[249] Birkhölzer, Karl and Ludwig Kramer (2004): ‚Grundstrukturen und Erfolgsbedingungen innovativer Arbeits- und Unternehmensformen in Sozialen Unternehmungen', in: Birkhölzer, Karl, Ernst Kistler and Gerd Mutz (Eds.): ‚Der Dritte Sektor: Partner für Wirtschaft und Arbeitsmarkt', Wiesbaden: VS Verlag.

a) Associations

Associations like Elpida (association of friends of children with cancer) or SOS Children Villages finance themselves with donations from the state, from foundations and citizens (crowd-funding).

b) NGOs

According to a list of the Ministry of Foreign Affairs, the following NGOs have received the highest amount of funding during the last 10 years: "Αλληλεγγύη", "International Mine Initiative", "European Perspective – Development and Education Center". These organisations receive government grants, donations and sponsorships by private companies. Most of these organisations are not innovative. In contrast we can observe NGOs like the Fair Trade Hellas which receives limited funding or Peliti which has sources from donations by its supporters and from its publications which are socially innovative organisations. For example, the alternative Community "Peliti" is a civil not for profit organisation which enabled 100,000 professional and amateur farmers to exchange seeds without money over the past 17 years, and thus, preserve the local plant species.[250] All people working for "Peliti" are volunteers. In total, roughly 100 volunteers offer their help in terms of work, knowledge, technical expertise etc. every year. Peliti started as an informal network of citizens and became a legal NGO in 2003.

c) Foundations

Foundations like the Foundation of the Hellenic world and Benaki Museum finance themselves from special grants from the Ministry of Foreign Affairs, European and national programmes, donations from private companies and foundations.

Both associations and foundations usually innovate through fundraising campaigns and income-generating activities. For example, Elpida established the first state-of-the-art oncology hospital for children in Greece. Elpida supports the work of the hospital, as well as raising awareness and mobilizing public opinion through innovative activities and events such as concerts and ballet performances by internationally famous artists, auctions of works of art, tele-marathons, plays, fashion shows, charity gala dinners, bazaars, and so on.

In the context of social innovation, however, it needs to be noted that the social economy in Greece tends to be less formalised. Primary social innovators in Greece are the non-typical networks of citizens. Atenistas, Time Bank, Car pools, Product distribution without intermediary networks etc. are the basic social innovators where social finance is limited and comes mainly from their supporters. Due to the financial situation in Greece, most social innovations take place in the field of society and the economy. Informal citizen networks support financially disadvantaged people through the distribution of goods and services. Social groceries, social clinics, fair trade unions and time banks are indicative examples of the prevailing situation concerning social innovation in Greece.

Social entrepreneurship constitutes a major aspect of the country's strategy to overcome the current economic and social crises, given that social enterprises are often "more resilient and contribute more to social inclusion if compared to conventional enterprises".[251]

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[250] http://www.peliti.gr/index.htm

[251] László ANDOR, Commissioner for Employment, Social Affairs and Inclusion, "Social entrepreneurship as an engine for job-rich growth and social cohesion – also in Greece", Concluding remarks, 1st meeting of the Commission's Group of Experts on Social Entrepreneurship, Brussels, Charlemagne, 5 June 2012.

Poland

The Polish social economy is quite diverse. However, predominant types of investee in the social finance sector are not defined in Poland and based on materials in Poland it is very difficult to estimate the form and percentage of engagement of investees in the area of social economy (also see section 2.1.4).

Portugal

In Portugal, there is again another categorisation commonly in use. In Portugal, the following are the main types of investees.

a. Social economy organisations providing social services
b. Agricultural co-operatives
c. Social economy organisations providing cultural and recreational services

a) Social economy organizations providing social services

Private organisations providing social services are, by far, the main group of non profit organisations in terms of employment and value added. This investee type is very heterogeneous concerning organisational and legal form. They can be associations, co-operatives, foundations, or religious organisations. There has been a significant growth among these kinds of organisations over the last few decades in terms of physical capacities (buildings, equipment etc.), mostly financed by public funds and private donations.

The major group of Portuguese SEOs are so-called IPSSs - "private social solidarity institutions", not in number of entities, but in terms of economic indicators (employment, value added). This is a group of private non-profit organisations devoted to the delivery of social services, mostly to elderly people, children and the disabled. They can have a variety of legal statuses (see WP2): associations (mutuals, "social solidarity associations" and "Casas do Povo" - "Houses of the People), cooperatives ("social solidarity cooperatives"), foundations ("social solidarity foundations") and organisations under Catholic Canon Law ("Misericórdias" - Holy Houses of Mercy, Social Parochial Centres, religious institutes delivering social services). This is the only group of social economy organisations which can benefit from a scheme of public support ("Protocolos de Cooperação" - Cooperation Agreements) with the following characteristics:

- It covers part of their operating costs;
- It is updated on a regular basis through negotiations between the three national confederations representing the IPSSs (CNIS - The National Confederation of Social Solidarity Organisations, The Union of "Misericórdias" and the Union of the Mutuals) and the Ministry of Social Solidarity;
- It is not dependent on EU funds.

The amount of state funding for this kind of “Cooperation Agreements” is more than €1.2bn per year. For the state financial support to investment costs, the private social welfare organisations, as well as the other social economy organisations have to apply to special programmes (some co-funded by the EU), if and when they are available which have a limited duration and specific eligibility conditions (see 3.2.3.) The regular IPSSs funding scheme established in the Cooperation Agreements is on a per capita basis: each organisation receives an amount of public money per person served by the organisation, up to a total number of persons per organisation. There is no geographical differentiation in the value of the per capita support, e.g., an organisation located in an urban area receives the same as one located in a remote rural area. The main differentiation of the per capita public support is according to the type of social services delivered, mostly to elderly people and children: elderly people in nursing homes, delivery of daily home care services to elderly people, children in kindergarten, etc. This public funding does not cover the full cost of these services, but it is an essential contribution for the economic sustainability of the organisations delivering social services to elderly people and children. The rest is usually covered by payments by the service users (elderly people and children's families) and various fundraising activities. Most of the current legal basis for this regime was established in 1992. Its rationale is a contract between the state and these private non-profit organisations. Here the state pays part of the costs of the social services they deliver because they have social importance and, with this kind of public support, those organisations can make those services accessible to persons who otherwise would not be able to pay for them. The organisations benefiting from this support have to sign a contract with the Ministry of Social Solidarity, they have to fulfil some technical conditions and they are subject to monitoring by the Social Security services.

b) Agricultural co-operatives

Agricultural co-operatives are the main segment of the co-operative sector which has also registered substantial restructuring and expansion in some products requiring relatively high volumes of investment in the last few decades. As in other countries, the co-operative type of social investee is too diverse to make a clear statement on which financial instrument is preferred here. Nevertheless, it can be reasonably assumed that agricultural co-operatives appeal to commercial banks, including the agricultural credit bank.

c) Social economy organisations providing cultural and recreational services

Social economy organisations providing cultural and recreational services are another important social investee in Portugal. They are very heterogeneous and quite large in terms of numbers: according to the Satellite Account for the non-profit sector, there were more than 22,000 of these kinds of organisation in 2006. That means that there are, on average, more than five of this kind of organisations per “freguesia” (the lowest level of territorial administration in Portugal). Most of these organisations are small and do not have good facilities. However, this is not the case with all of them. In recent decades, there has been significant investment in cultural, sports and other recreational facilities, as such, it could be argued that they are another significant kind of social investee. In most cases, investment in these kinds of organisations has been triggered by the launch of a public funding programme. Normally, these public funds are match funded, so the investee needs to secure investment from other funders. The way each organisation manages to obtain these funds varies from case to case; some do it by appealing to their own savings while others raise money through fundraising activities.

In Portugal, social enterprises are an emerging field. As such, they should not be seen as particularly important at this stage. They remain too small in number to have made a noticeable difference in the social situation of the country. They also don’t have a specific legal status – rather, they use existing legal forms such as associations and co-operatives.

In this context, it is also worth noting that some cases of social innovation which get more media attention because they are sponsored by large foundations, do not always yield as much social impact as the cumulated result of all the “minor” and anonymous innovations that happen and continue to happen every day within social economy organisations which have gone through the processes of physical and human investment mentioned above.

United Kingdom

It is fair to say that in the UK, the following types of organisations play the most important roles as investees in the field of social finance:

a. Grant funded charities and trading charities
b. Social enterprises
c. Co-operatives
d. Socially responsible businesses

a) Charities

Although this ranking is not based on empirically tested criteria, it is relatively obvious that these five types of organisations are among the central social finance investees. So in the UK, grant-funded charities (such as Shelter or Cancer Research) and trading charities (such as Save the Children, Oxfam, Action for Children, or Fifteen) combined are the most important actor in social finance. Although grants as their "preferred" instrument can not be seen as an investment instrument in a narrow sense, the aggregated financial volume of grants and donations qualifies grant-based charities as the most important actor in the British social finance field.

Concerning investment in both trading and non-trading charities, an important development is venture philanthropy. For example, with support from Impetus, St Giles Trust went from working in two prisons to working in 24 prisons, more than trebled its annual income, and grew the number of people it was able to help by 1500% over four years (2004 – 2009). The support package provided by Impetus included £522k of grant funding, £132k of management support, and £454k of specialist expertise covering business planning, media profile, bidding and tendering.[252]

Secured loans are also an important financial instrument as they are for other types of investees. In *Lighting the Touch Paper*, the Young Foundation and Boston Consulting Group found that in 2010 84% of social investment was in the form of secured loans.[253] There is also a large appetite for unsecured lending – and in part the social investment market is trying to fill this gap. For example, the sheltered accommodation provider, Le Personne Benevolent Trust, used a secured loan from The Co-operative Bank in 2011 to complete a major expansion of a sheltered housing complex in Surrey.[254]

b) Social enterprises

Social enterprises use a range of external finance instruments supplied by banks and other lenders such as Community Development Finance Institutions (CDFIs). Some social enterprises start life as voluntary sector organisations and develop a trading activity as an additional source of income. This often means that they have experience in applying for grant finance and consider this to be the most appropriate form of funding.[255] However, as aforementioned, social enterprises will often face difficulties accessing traditional grants as they do not have charitable status – which is often a necessary condition for grant recipients. Grant finance can be crucial at the start-up phase as well as helping social enterprises leverage in commercial finance at other stages of development. And

[252] Viewed 23 July 2012, http://knowhownonprofit.org/funding/social-investment-1/social-investment
[253] Adrian Brown and Will Norman, Lighting the Touchpaper: growing the market for social investment in the England, London, Young Foundation and Boston Consulting Group, 2011
[254] Viewed 23 July 2012, http://knowhownonprofit.org/funding/social-investment-1/social-investment
[255] Bank of England, *The Financing of Social Enterprises: A Special Report by the Bank of England*, Park Communications Limited, London, 2003

approximately 61% of social enterprises apply for development grants.[256] One quarter of social enterprises apply for loans.[257]

c) Co-operatives

In terms of social finance, co-operatives are a difficult object of investigation, because as social finance actors they may act in very diverse ways; they can be investors as well as investees. Co-operatives receive grants, take out loans and can issue shares. We haven't found any evidence of a particular preference for a specific type of financial instrument.

d) Socially responsible business

This category covers profit-making commercial businesses which conduct their operations in a socially responsible manner taking into consideration the social impact of their operations. They are often profit-making but not profit maximising. We could not find evidence of a preference but the major forms of capital investments are loans and equity investments.

[256] Social Enterprise UK, *Fight back Britain*: *A report on the state of social enterprise survey 2011*, Social Enterprise UK, London 2011
[257] Social Enterprise UK, *Fight back Britain*: *A report on the state of social enterprise survey 2011*, Social Enterprise UK, London 2011

5. Conclusions, prospects and final remarks

5.1. Summary: Central Findings

5.1.1. Finding 1: Social economy, social innovation and social investment

The relationship between the social economy, social investment and social innovation is still a black box. There are many social innovators and organisations that are socially innovative but we cannot say that in general, one kind of organisation is more innovative than another. As such we cannot identify the types of organisations which are the 'primary social innovators', or the most socially innovative in any given country. Also, not all social innovators will require 'social finance' as social innovation can take place in the private sector (for which mainstream finance can be assumed to be available) and the public sector where different financial arrangements are made. Many kinds of organisation can in theory be socially innovative and we can find examples of social innovations across all investee types, however, it is not possible to say that some parts of the social economy are more or less innovative than others or that they tend to be socially innovative in a particular way. There is very little empirical evidence to say that some types of organisation are more innovative than others – there are some assumptions that social enterprises are more innovative but this is not grounded in factual evidence that we have seen. As long as we cannot identify the main kinds of social innovators, we can not draw reliable conclusions about how these organisations are financed, let alone how social innovation is financed more broadly.

5.1.2. Finding 2: The state plays a central role in TEPSIE countries' social economies

Throughout, this report makes it clear that there is no single market for social investment in the EU. The six countries described herein all exhibit vastly different social finance and investment characteristics. However, one common feature is the centrality and importance of the state in the social economy, social finance and thus – it may be assumed – to social innovation. While of course not surprising, this is one of our central conclusions, and of major importance due to its implications. In all TEPSIE countries, the state is linked to the social economy in numerous and highly complex ways – as a grant provider, investor, co-investor, investee, intermediary, buyer, seller, procurer, outsourcer, and partner, etc. Often it plays several roles at the same time. As a result, the relationship between the state and the social economy is highly diverse and varies from country to country; it is even more complex when the ties to the European Union are taken into consideration. This report could only briefly touch upon this subject; however, other papers in WP4 and other work packages will aim to shed more light on the role of the EU in supporting members' social economies. Another important fact to note here is that the social economies we have investigated are far from being independent sectors, since the ties with the state are too strong and numerous. We have observed four main patterns: [258]

- UK - relatively independent social economy, with the state increasingly purchasing and procuring services from social economy organisations rather than providing grants and donations; even though the social economy is perceived as rather independent from state

[258] These patterns are compatible with the notion of four different types of welfare state regimes in Europe: The liberal, anglo-saxon type, the continental (corporatist) model, the Scandinavian welfare state, and the Mediterranean ('rudimentary' or 'Southern') welfare state (see Leibfried, S. (1992) 'Towards a European welfare state? On Integrating Poverty Regimes into the European Community', in Z. Ferge and J. E. Kolberg (eds) Social Policy in a Changing Europe. Frankfurt am Main: Campus Verlag; Ferrera, M. (1996) 'The "Southern" Model of Welfare in Social Europe', Journal of European Social Policy 6 (1): 17–37)

funding in comparison to other European countries, the state in the UK still plays a major role in resourcing social economy organisations, either by procuring goods and services and/or disbursing grants and loans, usually through intermediaries. [259]

- Germany and Poland - traditionally, free welfare organisations have played the major role in the social economy; they are independent from the state, but still closely linked to it via various institutional ties ("sozialrechtliches Leistungsdreieck"). These organisations still play the central role. Poland is relatively close to this traditional model with the exception that EU funds play a larger role.
- Denmark - the state is more important and plays a more direct role. In all the main sectors of the social economy, social services are operated by the public sector and virtually all of them are financed by the public sector. They are on-going service operations based on past identification of needs, and they are strongly embedded in the fabric of comprehensive institutional systems.
- Portugal, Greece - in Portugal, private welfare organisations have played the major role in the provision of social services (for the elderly, children and those with disabilities, and in the fight against poverty); they are independent from the state in terms of creation and governance, but not in terms of operating costs or financing investment; in the last 20 years, this interaction has been formalised through contracts between the state and the national confederations representing those organisations. Much of the state's co-financing of investment costs of private welfare organisations has been organised within the framework of EU-co-funded programmes (as with other sectors and organisations in the economy). In Greece, the situation is similar although informal and family networks play a slightly larger role.

National governments and the EU play a key role in relation to social innovation in each of the TEPSIE countries. Indeed, national governments and the EU have set up numerous programmes to promote innovation. It remains a central aim of this project to learn more about these programmes, how effective they are in fostering innovation and how they can be improved.

5.1.3. Finding 3: The main funding instruments for the social economy and social innovation

Overall, in the strictest sense of the term, there are no predominant *investment instruments* in widespread use. The major funding vehicles for the social economies of all TEPSIE countries are public funding, earned income, or grants and donations. None of these vehicles may be termed investment instruments in a strict sense (although of course all of them do constitute capital flows for the social economy). The ratio between public grant funding and earned income has changed and is increasingly moving towards earned income. But investment instruments such as loans or equity investments are fairly rare, with Germany and UK being exceptions concerning social bank loans and the UK for new financial instruments such as quasi-equity, SIBs and so on. Thus, although exceptions may be seen in the UK where the social finance sector is most developed, and in Germany where free welfare organisations have a long tradition of co-operating with social banks, social finance investment instruments are fairly uncommon. This is particularly true for social innovation: we have seen little evidence to suggest that specific social finance instruments are being used to finance social innovation in a targeted way. The link between social innovation and social finance instruments is still to be established. This issue is critical to the overall work package and as such, we will continue work in this area by collecting examples of successful social innovations and identify the ways in which they were funded.

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[259] J Clark, D Kane, K Wilding and P Bass, *The UK Civil Society Almanac 2012*, National Council for Voluntary Organisations, London, 2012

What we can say at this point in time is that there are some investment instruments in use that are designed and set up to focus on social innovation. It is fair to say that in the UK the most common instruments for promoting social innovation are innovation funds or social enterprise funds (e.g. SEIF and DWP's Innovation Fund). In Germany, besides the KfW programme for social entrepreneurs already mentioned, there are also some promotion programmes in place particularly targeted at social innovation. Many of them have been set up by the state under the supervision of the Ministry of Family Affairs, Senior Citizens, Women and Youth.[260]

5.1.4. Finding 4: Main resource providers and investors

In terms of predominant investors, our main finding is that the state is still the single-most important resource provider in all TEPSIE member states' social economies. Although intermediaries and funding channels do vary, the source of funding is usually public. It should also be clarified that what is termed earned income is often revenue from public sources. So overall, the state is by far the most important resource provider in social finance. However, this does not necessarily imply that the state is also the most important *investor,* for earned income must not be confused with investment.

The most important conclusion to be drawn here is that social investors still play a relatively marginal role, with the UK and probably Germany being potential exceptions. Particularly in Greece, Poland and Portugal, direct dependency on public and EU funding sources is prevalent for the social economy. In these cases, philanthropy is rather low, and the presence of social investors as well as the application of advanced social finance instruments is at best sporadic. So while there are some signs of the emergence or development of a philanthropic field, there are almost no signs of a social finance market with visible and established social investors, such as social banks or social investment funds.

In the UK and Germany, we get a slightly different picture with social banks having been in business for several decades now, and also with huge sums of philanthropic donations available to SEOs. Nevertheless, in relation to the state as the dominant resource provider, the total relevance of actual social *investors* is still marginal even in the UK, which is Europe's most advanced social investment market. In this respect however, it is important to note that in Germany, the state acts only as an intermediary for financing the large free welfare organisations, i.e. the single-largest part of the German social economy is not financed from taxpayer sources. Nevertheless, there is huge potential for generating capital flows for social economies from non-state sources in all partner countries.

Overall, this situation illustrates that the social economy still depends heavily on two legitimising institutions: the state (for public funding) and the market (for earned income). Those parts of the social economy that do not generate earned income are still largely dependent on the state or philanthropic giving, the latter being still relatively undeveloped in Greece, Poland and Portugal. The point here is that *social investors* (as opposed to grant makers and donors) play a marginal role in total, and there is vast potential for more actors to get involved in social investment. The number and relevance of investors who expect both a social return and at least a modest rate of financial return is still very limited. Thus, we can say that overall the question 'what kind of return do investors expect?' can still be answered quite 'traditionally': they either expect market rates of return (in case of loans or of value-for-money) or some proof that their money was spent for a specific purpose (in the case of public funds and grants/donations). Although it is a significant and

[260] See for instance http://www.bmfsfj.de/BMFSFJ/Freiwilliges-Engagement/mehrgenerationenhaeuser.html or http://www.bmfsfj.de/BMFSFJ/Freiwilliges-Engagement/engagement-staerken.html viewed September 24, 2012.

visible trend among social investors to ask for impact (or some equivalent) while expecting a modest or even market rate of return, the fact that social investors of this kind still play a marginal role distorts the overall picture.

The effect of this constellation is that the state and EU currently finance most social innovation. Given that there are only a very limited number of financial instruments for social innovation in use, social investors are generally not relevant for financing social innovation. In most cases, they provide capital for 'traditional' investment, i.e. bridging or development capital to be invested in tangible assets. Social innovation can currently not be financed with the means available to investors on a large scale. Therefore, it is largely the grant finance of the state that provides SEOs the opportunity to innovate socially. To a comparatively limited extent, this can also be said of the grant finance from foundations and donations from private households.

5.1.5. Finding 5: Pros and cons of different kinds of funding instruments

Table 5-1 – Pros and cons of different funding instruments

Instrument	Pro's	Con's
Debt	• Long-term reliable source of funds • Lower capital cost than equity • Greater flexibility to decide how money is used • Can incentivise business planning – bringing efficiencies to an organisation's activities. [261]	• Interest payment and payoff mechanism unsuitable for early-stage innovation • Cultural aversion to borrowing – trustees of a charity may be exposed to personal liability for a loan, if the charity is unincorporated • Rather 'blind' to social aspects
Equity	• Long-term reliable source of funds • Involvement of investors in operations may be useful • Potential for involving target group directly through investment • Can incentivise business planning – bringing efficiencies to an organisation's activities[262]	• Relatively high cost of capital • Reduced organisational and strategic flexibility • Not available for organisations that cannot issue shares • Lack of exit strategies
Quasi-equity/ Mezzanine	• Better alignment of the cost of capital with business performance • Less costly and time-consuming than raising equity finance • Less risk of dilution of ownership and control	• Overly complex arrangements (e.g. with numerous thresholds) – can lead to confusion over agreed terms • Skills and confidence required to negotiate
Grants	• Non-repayable • Relatively high degree of independence	• Tend to be short-term • Restrictions imposed on the use of funds • Can encourage 'mission drift'

[261] Bank of England, *The Financing of Social Enterprises: A Special Report by the Bank of England*, Park Communications Limited, London, 2003
[262] Bank of England, *The Financing of Social Enterprises: A Special Report by the Bank of England*, Park Communications Limited, London, 2003

	• Enable social enterprises to operate in difficult markets or deprived areas[263]	• Often paid in arrears leading to cash flow difficulties • Bureaucratic application processes • Some grants are only available to charities • Grants can distort social investment market
Prizes	• Numerous prizes specifically targeted at innovation • Fairly simple qualification process	• Sometimes awarded a long time after innovation has been implemented
Earned income	• Highest degree of independence • Contracts are legally binding for both parties • Contracts tend to be longer than some grants	• Exposure to market volatilities • Charity law imposes restrictions on the nature and level of trading activity charities can carry out[264]
Crowdfunding	• Less formalised than other forms of debt	• Generally low amounts of capital available

5.1.6. Finding 6: Barriers and challenges to social finance and investment

Of course, there are numerous and diverse barriers and challenges facing the development of the social finance and social investment fields in all TEPSIE countries. While it is one of the central aims of WP4 to deepen our understanding of the subject here, the following summary based on this report can only provide an overview:

- The grant dependence of SEOs hinders the development of a functioning social finance market. As long as the social economy is as dependent on public grants, it will not develop as a sector, let alone as a sector with its ‘own’ finance sector. Thus, governments and public bodies do carry some responsibility when it comes to supporting the development of the social economy. Besides acting as a disincentive to take on and/or develop new forms and instruments of social investment, grants can also encourage 'mission drift'. Nevertheless, due to the assumed nature of social innovation, grants still play a crucial role here. So the ‘problem’ of grant dependence may be even worse for financing social innovation. This and probable solutions will be a central area of further exploration.
- There is a lack of “fit” between SEOs (potential investees) and (potential) investors due to the lack of business skills, professionalization, and financial literacy across the TEPSIE countries’ social economies. As earned income becomes more important and a wider range of financial instruments and social investors become more available and involved, SEOs need the skills to manage that. Partly as a result of a lack of these skills, most SEOs “face prohibitive fundraising costs, do not get the right funds at the right conditions, and hardly ever get funds when they can best use them to grow their innovations to scale.”[265] Two of the most obvious results attributable to this set of problems are that a) expected

[263] Bank of England, *The Financing of Social Enterprises: A Special Report by the Bank of England*, Park Communications Limited, London, 2003
[264] Charity Commission, *Trustees, trading and tax: How charities may lawfully trade*, Charity Commission, Liverpool, 2007
[265] F. Oldenburg (2012): ‘From Solar System to Ecosystem: A New Way to Finance Social Entrepreneurs’ http://www.forbes.com/sites/ashoka/2012/07/02/from-solar-system-to-ecosystem-a-new-way-to-finance-social-entrepreneurs/

risk-adjusted rates of return are often too high for the social sector, and b) it is difficult to balance investors' preferences for quick returns with the sector's need for long term patient capital.[266] The latter is assumed to be particularly important for social innovation which – as opposed to technological/business innovation – often does not generate quick returns.

- Bureaucracy is a major problem in many important areas, particularly grant approval and the taxation of earned income. So, where social innovation does generate returns (quick or not) then taxation may become a barrier.
- The options for showing non-monetary returns are still very limited and this constitutes a major barrier to social investment (worsening the information asymmetry problem inherent in any investment). Impact may be particularly difficult to measure in the case of social innovation because of the inherent newness of the innovation.

5.2. Trends

Based on the previous sections as well as literature and data reviews, we can extract some trends that are currently unfolding in the social finance and investment fields. These include: the growing importance of earned-income strategies; that SEOs are increasingly diversifying their financial instrument mixes and employing relatively new instruments; commercial investors and investment managers are becoming increasingly aware of social investment as an attractive opportunity; SEOs are becoming more professional in terms of business skills and financial literacy; and finally, the links between investors and investees concerning the governance of investment projects are becoming closer. These trends will be discussed in detail in the following sections.

5.2.1. Trend 1: Earned-income strategies are becoming more important

Although reasons are diverse in TEPSIE partner countries, earned income strategies are becoming more important in all of them. In the UK and Germany, earned income has been a major finance source in the past, but sales, fees from services or membership, investments or renting property are currently becoming even more relevant. When looking at investments taken on by innovative organisations, the 'pecking order' theory of finance applies; generally, the source of development capital preferred for this investment is internal.[267] Thus, for social innovation we may assume that earned income will also increase in importance as a funding source. However, earned income strategies are becoming increasingly relevant and paramount to SEOs for various different reasons. Instead of SEOs intentionally and strategically choosing to go for earned income, they are subject to external pressures urging them to do so either directly or indirectly. This may also affect social innovation of course because it tends to limit the amount of capital available for non-core business activities. Overall, it must be seriously doubted whether earned income generates quantities of capital beyond the level to cover costs to an extent necessary for investing in social innovation.

It is fair to say that the overall financing landscape for SEOs has become tougher mainly due to increased competition and decreasing public funding opportunities in the last decade which has particularly worsened for the countries most affected by the economic crisis. Thus, financing pressures towards earned income strategies are taking primarily two forms: first, there are fewer public service contracts and they are increasingly tendered out on a competitive basis; as a result, more and more SEOs find themselves outcompeted and thus have to find alternative revenue sources. And second, the competition for grants and donations has increased. In the UK, for

[266] Clearly So, *Investor Perspectives on Social Enterprise Financing*, City of London Corporation, London, 2011
[267] FINNOV, 'Experimentation: Final Policy Report', Work Package 3.6, 2011

instance, there has been a shift away from grants towards service contracts for SEOs in the last two decades: £4.2bn of the statutory funding in 2006-07 was received as grants, down from £4.6bn in 2000-01, whilst contract funding increased over the same period from £3.8bn to £7.8bn.[268] That has led many SEOs to develop revenue strategies to reduce their dependence on grant funding, such as having a trading arm or trade more generally.[269]

Aside from these developments there are other reasons for the increasing importance of earned income. First of all, financial sustainability has always been, but is also increasingly being seen as an objective in its own right. This may be seen as an expression of the economisation of the social economy but economic self-reliance and autonomy are both considered to be desirable societal values and promoted by actors from politics and the economy. The trend, therefore, is to promote financially viable organisational models in the social economy.

This is especially the case in Denmark where there has been a clear trend of supporting and scaling innovations (particularly in the field of clean tech) to a level where real business models become possible so that both market based and earned income finance become viable options. Examples from other sectors and other countries give reason for cautious optimism. Another trend in this respect is the growing number and visibility of hybrid organisations and social entrepreneurs that are gaining increasing media attention under headings such as "Doing well while doing good".[270] In contrast to the economisation of the social economy, this trend may be interpreted as an expression of an opposite trend, i.e. cultural patterns leading to increasing socio-environmental awareness and calls for sustainability among Western populations, particularly among the younger generations. Although we need to note that the underlying business models are not all entirely new (fair trade has been in place for a number of decades now), their increasing popularity is an important trend towards more SEOs being established on earned income models. Government policies which aim to develop a more supportive legal environment are also important factors in SEOs' ability to generate income from economic activities, thereby supporting their non-profit missions. It remains to be seen to what extent society and politics can build on the momentum of this important *Zeitgeist* phenomenon and how this will affect the next generation of social innovations.

5.2.2. Trend 2: Diversification of finance instruments and instrument mixes

Historically, SEOs have not had many options when looking to secure investment, especially for social innovation. This is still the case today; as we have seen, where SEOs do secure external investment, they usually do so through traditional funding channels (i.e. grants from the state, foundations and/or loans from social banks) and for 'traditional' investments in tangible assets rather than in social innovation. For particular types of SEOs, such as German free welfare organisations, there have been special investment sources, in this case the Bank für Sozialwirtschaft; but also in this case, we have both a single source and instrument of investment.

However, there are a number of reasons why this situation may change in the future. First of all, with the current economic crisis, the social economy, its investors and stakeholders have all entered a period of increased uncertainty. Public sector cuts in all TEPSIE countries have impacted heavily upon SEOs. Funding for charities has been cut, resulting in many charities fearing they will

[268] Summarised in R Macmillan, *The third sector delivering public services: an evidence review,* Third Sector Research Centre Working Paper 20, 2010
[269] A Nicholls, 'Social Enterprise and Social Entrepreneurs' in M Edwards (ed.), *The Oxford Handbook of Civil Society*, Oxford University Press, Oxford, 2011, p. 82
[270] L.L. Embley (1992): 'Doing Well While Doing Good: The Marketing Link Between Business & Nonprofit Causes', New Jersey: Prentice Hall.

have to close down. The growing strain on public sector resources has led to greater pressure on SEOs to become less reliant on a single stream of income and investment. This constitutes an external pressure for them to move away from traditional models of fundraising, diversifying their revenue streams and investment sources. This will have significant impact on their capability to innovate socially, although we have not gathered much evidence to make statements about what this impact will look like.

Investors are also seeking to differentiate their investment instruments. In 2000 there were hardly any charities providing capital investments (other than grants) to mission driven organisations.[271] There is now a far greater range of options open to grant making charities – loans, quasi-equity etc. as well as mission connected investment and venture philanthropy. While there are still relatively few charities involved in social investment this is a growing and important trend at least in the UK.

In terms of investors, an important trend seems to be the emerging field of impact investment. That there are a range of impact investors who are willing to invest in the billions if the scale is right can be seen from the development of huge renewable energy innovation projects in Denmark. Concerning other social innovation projects, investment opportunities are just too small in scale to make sense for impact investors. It remains to be seen whether some of the investment needs and opportunities can be consolidated at a scale that can be of interest for impact investors.

At the same time and in the same context, practitioners and academics are calling for a reduction in the prevalence of the “St. Matthew’s Principle”, namely, the allocation of resources to successful and already well-resourced organisations while neglecting small organisations struggling to make it through the “valley of death”. Thus, both the need and the options for more diverse, complementary and also venturesome resource strategies are being discussed and advocated. And with the current rise of new and promising instruments (see 3.2.1) this diversification is becoming a more realistic scenario. Important actors in this respect are government-affiliated institutions like Big Society Capital in Britain, the KfW in Germany and others. In this respect, it is useful to emphasise the calls by many actors involved in social investment for a massive reduction in the bureaucracy prevalent in financing schemes of public and large private resource providers (such as foundations).

Even though many of these instruments are still in their early phases of development, they are gaining prominence. For example, one of the most exciting developments is around crowdfunding, even though the concept is not entirely new. Other important trends are bilateral investment agreements and match funding. Networks and collaboration, especially with businesses (as part of their growing efforts in CSR, corporate citizenship, corporate philanthropy, etc.) are also becoming increasingly interesting options for SEOs. In terms of specific instruments, at least in the UK, there are also interesting developments around Social Impact Bonds, charitable bonds and new forms of ‘quasi-equity’ such as revenue share agreements (also known as revenue participation schemes) and types of convertible grants (which can be converted into equity). [272] The new social stock exchanges in Portugal and the UK are also likely to open up new funding opportunities to SEOs.

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[271] The Magic Roundabout: How charities can make their money go further; an introductory guide to Programme Related Investment (May 2003). Foundations and Social Investment – making money work harder in order to achieve more (October 2005). Mission Possible – emerging opportunities for mission connected investment (May 2008). Financing Civil Society: A Practitioner’s Guide to the Social Investment Market (September 2008) and Access to Capital: A briefing paper (September 2009).

[272] The Magic Roundabout: How charities can make their money go further; an introductory guide to Programme Related Investment (May 2003). Foundations and Social Investment – making money work harder in order to achieve more (October 2005). Mission Possible – emerging opportunities for mission connected investment (May 2008). Financing Civil Society: A Practitioner’s Guide to the Social Investment Market (September 2008) and Access to Capital: A briefing paper (September 2009). See also, Joe Ludlow and Jonathan Jenkins, ‘Twenty catalytic investments to grow the social investment market, The Big Society Finance Fund, London, NESTA, 2011.

Finally, non-financial capital flows are also important; volunteer hours, peer-to-peer support as well as in-kind 'investments' are also becoming increasingly prevalent, since the possibilities for co-ordinating them (via the Internet and/or alternative forms of banking, such as time banking) have improved vastly in the last decade.

Concerning social innovation, we have to state that at this point in time we have not yet gained much insight into its links to various forms of investment. Here, we will deepen our understanding substantially in the coming phases of the work package, primarily by means of case studies, interviews and focus group discussions with practitioners.

5.2.3. Trend 3: Commercial investment managers and intermediaries are increasingly aware of social investment

At the same time as SEOs are exploring new forms of investment, investment managers are starting to see social investment as an attractive investment opportunity.[273] Another, less obvious reason for this growing interest in social investment is that at least in the past decades, banks have often had excess liquidity that they have had to invest somehow. For reasons of diversification, these funds were sometimes channelled to the social investment market, the result for social banks and other social investors being increased competition from 'cherry-picking' commercial investors.[274] Nevertheless, commercial investors are here to stay, because they have realised that social investment is an attractive investment option. Indeed, socially responsible investing (SRI) is one of the top trends among major commercial investors, and as it gains more momentum, for better or worse, these investors will further diversify their portfolios towards more socially and/or ecologically sustainable investments.

Recent developments in the field of microfinance could be a potential warning sign for the field of social investment. In the past few years, it has become clear that the aims, objectives and practices of corporate investors are not compatible with the original idea of microfinance. For instance, the returns on investment commanded by some commercial investors are often excessively higher than past market rates, ultimately leading to excessive interest rates for microfinance investees. Thus, the increasing presence of commercial investors is seen rather critically among social economy actors; nevertheless, it must also be viewed as an opportunity for the investment mix diversification that is called for.

One of the particularities of our present situation is that the wealth accumulated since WW II has not been spent on war or inflation, which has led to vast amounts of capital available to social investment ('heritage philanthropy'). Here, two aspects are important in terms of social innovation: first, the nature of these philanthropic funds may be assumed to be suitable for social innovation, because short-term financial returns play minor roles. And second, commercial investment institutions may become even more important intermediaries. In this role, they also become increasingly important for social innovation.

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[273] Saltuk, Y. / Bouri, A. / Leung, G. (2011): Insight into the Impact Investment Market - An in depth analysis of investor perspectives and over 2,200 transactions, J.P.Morgan, http://www.thegiin.org/cgi-bin/iowa/resources/research/334.html

[274] Schmitz B./Glänzel G. (2011): 'Organisational Hybridity in Social Finance: A Comparative Case Study', Working Paper presented at the 15th Annual Conference of the International Research Society for Public Management (IRSPM XV), Trinity College, Dublin, Ireland.

5.2.4. Trend 4: Increasing professionalization of SEOs: business skills and financial literacy

Another visible trend is the increasing professionalization of SEOs, especially in terms of business skills and financial literacy. A barrier frequently identified by investors, particularly commercial investors, is that SEOs lack these very competencies, and thus investments in SEOs are too risky or yields a relatively unattractive ratio of risk and return. However, and partly to overcome this barrier, SEOs have invested in training staff or hiring new staff with the appropriate business and financial skills. Two of the indicators of this trend are that the ratio of former business people in key SEO positions has increased and also that there are increasingly numerous university and other education programmes to teach non-business people business skills, some of them expressly targeting SEO and NPO managers.[275] Again, although this trend is clearly visible in the field, it is not yet widespread across all TEPSIE partner countries. Actually, the lack of business skills is still one of the most frequently identified barriers to social investment. However, this barrier is not present on the same level in all TEPSIE countries. For example, in Greece and Portugal, this is a greater challenge than in the UK or Germany. And of course, it also varies depending on the size of the organisation and the level of institutionalisation of the field.

Therefore, there is significant potential to learn from actors that are more advanced in this respect. However, the doubts and criticism in large parts of the social economy must also be reflected here, for obviously this trend is also a reflection of the 'economisation' of the non-profit sector which may also have harmful effects on social innovation. On the other hand, financial literacy and the capability to set up investment plans may also enable SEO managers to secure forms of investment for social innovation that have so far not been available, i.e. the problem of grant dependency may be reduced when it comes to financing social innovation.

5.2.5. Trend 5: Governance: closer links between investors and investees

One of the most 'classical' challenges of social finance and social investment is the fact that both social ends (mission, objectives) and social returns (outcome, impact) are very hard to measure and account for when choosing or designing an investment instrument. For example, how much discount on regular market interest rates should be given for a loan intended to finance a social project? How do you account for both risk (the economic risk of loan default and the social risk of the social mission failing) and return (economic and social)? How do you detect and measure the actual success of the social mission?

Partly (but not solely) as a result of this classical social investment problem of information asymmetry, investors and investees have been collaborating increasingly closely in recent years. The rationale is simple: because risk and return of social investments are hard to assess reliably, the actors involved work together towards outcomes that are desirable for both sides or – in the case of multi-stakeholder constellations – for *all* sides. This kind of participatory governance is not new, because the trade-offs between social and economic goals and returns are inherent to social finance and investment. However, this new trend of closer collaboration can be seen in: bilateral investment agreements; venture philanthropy; mission-related investment of foundations' endowment (albeit for slightly different reasons than the ones just set out). Co-operative organisational models also aim to involve a wider range of beneficiaries as they often seek to include beneficiaries or customers and make them co-investors, such as regional co-operatives in agriculture or energy production.

[275] Glänzel,G., & Schmitz,B. (2010) 'Organizational Hybridity Concept and Hybrid Organizations Typology', Working paper presented at the ARNOVA Annual Conference, November 2010, Washington.

Increasing closeness of collaboration may also reduce some of the problems connected to investment in social innovation: the high degree of risk involved in innovative projects may then be easier to assess for potential investors; they may be in a better position to build their own judgement. Based on long-term and close involvement with an SEO wanting to innovate, the potential investor is likely to be more committed and thus willing to provide forms of investment that 'externals' would not.

5.2.6. Trend 6: Risk, return, impact and different investment instruments

There is a strong link between social impact and social finance: what qualitative and quantitative impact has been made by an investment? How do you measure the social impact of each Euro invested (without being directly involved in qualitatively assessing results)? As aforementioned, most actors of the advanced social investment markets aim specifically to support 'high impact' organisations. Moreover, many grants are intended to support the missions of charities – and thereby enhance their impact. In this sense, social finance is seen as a means of helping mission driven organisations deliver impact. In a more specific sense, there are challenges in measuring social impact which make it difficult for SEOs to secure investment and difficult for social investors to calculate risks/rewards and therefore make investment decisions. So, there is a huge interest in developing new models for measuring social impact in order to better guide investment decisions. This has been a key issue over the last few years.

One key challenge is to develop ways of linking social finance with social impact and social innovation effectively. This is a major challenge due to the risks inherent in any form of innovative project. As a result, there are currently no instruments in widespread use. However, there are some interesting developments in this space. Quasi-equity, for example, may be seen as a potential link between innovation and investment, because of the flexibility it offers in terms of structuring the investment; this flexibility enables the inclusion of social aspects and objectives in the investment. Social Impact Bonds (SIBs) may become established as a more sophisticated tool. While SIBs show much promise, they remain largely untested. Indeed, a number of questions remain open: where could SIBs be most useful? How should they be structured? And, will they actually work?

5.3. Hypotheses and Further Research Requirements

As we have seen, we can not establish a direct link between investment and social innovation. Therefore, we need a consecutive analysis of the options for generating capital flows for social innovation. As a first step in this analysis, WP4 aims to answer four questions:

1. What are the main funding schemes for the social economy?
2. What are the pros and cons of different forms of funding?
3. How does funding influence the strategy and organisational development of social economy organisations?
4. What kind of returns do investors expect and how can non-monetary returns be shown?

In terms of the first question, this report has provided an overview of the social finance and social investment fields in the TEPSIE partner countries. However, further research is needed to answer the following questions and to establish the links between investment and social innovation; these will be the focus of subsequent deliverables in WP4. The following hypotheses will be tested in subsequent papers from which we will develop a more profound understanding of the field as well as its links to other WPs. The next deliverables will focus on the questions above and provide options for further research.

Hypothesis 1: Social innovation flourishes in spaces protected from financial market pressures

So far, the link between the social economy and social innovation has not been explored profoundly. A potential link between the social economy and social innovation can be seen in the hypothesis that grant-financed SEOs are less subjected to (financial) market pressures than businesses and that they therefore have more room to experiment; grant-financing creates a 'protected space' for social innovation. In this protected space, innovations do not have to pay off immediately or within some foreseeable time. They may be continued for their own sake, because they produce socially desirable results. Social innovation is potentially a form of impact that grant-providers accept. For instance, operative foundations are a major player in many countries' social economy, but besides and beyond that they also very often focus explicitly on social innovation. So, in their operative projects, they concentrate on innovative projects and/or projects aimed at researching or fostering innovative approaches. Here we witness a very visible link between the social economy and social innovation which is most often not as visible in the lion's share of the (social) economy.

However, this holds 'only' for grants and other forms of 'soft' capital with no or very limited return requirements. Concerning this 'protected space hypothesis', we need further research on the types of capital available for funding SEOs and particularly on how SEOs finance social innovation. Although we do have some empirical data on the financing of SEOs, this data is still scarce. Yet it is rich in comparison to the data we have on the way SEOs employ their funds to finance innovations.

The example of operative foundations gives a hint, yet much more research is needed to examine the protected space hypothesis. Also, the relation between internal capital sources, investment and innovation is both a starting point to look at but at the same time an area in which we need further empirical evidence. Concerning the interrelation between SEOs, social investment, and social innovation, the literature on financing social innovation from *internal* capital sources and particularly literature on *combining internal and external sources* is scarce and largely limited to theoretical accounts about the innovative options *potentially* available to SEOs.[276] So there is a research gap concerning: the conceptualisation of internal cash flows and other forms of capital as sources for investment in social innovation; the interrelation of customers and the state as resource providers and as providers of resources partly available for social investment; and the potential to involve various types of social investors.[277] All of them have different influences on the options and possibilities for SEOs to experiment and to take particular forms of risk. This is also why risk capital is so often emphasised in debates about the social economy and social innovation - risk expresses the investor perspective on what is a protected space from an investee perspective. Thus, the link between different forms of funding and social innovation in this respect should attract more research attention.

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[276] Achleitner, Ann-Christin, Wolfgang Spieß-Knafl, Andreas Heinecke, Mirjam Schöning, Abigail Noble (2011): 'Social Investment Manual: An Introduction for Social Entrepreneurs', http://www.schwabfound.org/pdf/schwabfound/SocialInvestmentManual.pdf

[277] Bachert, Robert and Andrea Schmidt (2010): 'Finanzierung von Sozialunternehmen. Theorie, Praxis, Anwendung', Freiburg: Lambertus.

Hypothesis 2: In the process of an invention becoming a social innovation, social finance and public support can be regarded as indicators

It should be noted that in the first phases of the invention/innovation cycle, there are few investors while in the start-up and growth phases, this number does not necessarily change (while investor composition may and usually does change). The more the number of investors increases over time - many individual "investors" providing small or large amounts – the more the innovation may be regarded as a success and socially and democratically legitimate (of course, public funding fulfils this role as well); many small investors may thus be regarded as a kind of indicator for a *license to operate*.

In this respect it is also worth noting that social innovation does not always have to involve ground breaking newness, large-scale changes or even the establishment of an organisation. It may be hypothesised that the majority of past innovations have been unobtrusive, small, and incremental improvements that have been continued because they provided (contributory parts of) better solutions to social problems – and they were financed as organically growing parts of these solutions.

Hypothesis 3: Social innovation is not generally limited to certain types of organisations financed in specific ways

In general, social innovation is not limited to certain types of organisations financed in specific ways; certain innovative processes are, however, more often found in specific types of organisations which may prefer or require specific funding schemes. So far in this report, there is no evidence to say that some types are generally more innovative than others. However, we do have some hints and assumptions calling for further research; we need to differentiate the notion of social innovation more profoundly and define organisational characteristics to compare it to. For instance, there are some assumptions that social enterprises are more innovative but this is not grounded in factual evidence that we have seen. There is probably an important piece of work that could be done exploring the link between social enterprise and social innovation, particularly concerning the exact mode of innovation in these organisations as well as financing patterns. Also, we tend to assume that secured lending, as the safest form of investing, is the least likely to stimulate innovation. Again, this could be the subject of further research. [278]

At this point in time, there is a general lack of empirical knowledge about non-grant sources of finance among social economy organisations.[279] All of the financial instruments potentially have a role to play in social innovation. So, there is a need and much potential for development. Here, the development of the social investment market in general is important because it will increase the availability of capital, and in particular risk capital, for social economy organisations – and this will increase the amount of data to test hypotheses.

Hypothesis 4: Further institutionalisation of the social finance field will increase commercial investors' engagement and the diversification of instruments

[278] A, Brown & W, Norman, 'Lighting the touchpaper. Growing the Market for Social Investment in England', Boston Consulting Group, Young Foundation, London, 2011
[279] Bank of England, 'The Financing of Social Enterprises: A Special Report by the Bank of England', London, 2003

From a sociological point of view, the institutionalisation of the social finance field is a promising future research area. The underlying logics of social investment as well as the trajectories towards innovative finance instruments and financial engineering should therefore attract further research attention.[280] This issue points to necessary research at the cross-sections of social investment with other research topics relevant to social innovation. In particular, taking into account that financing a project is per se a social process, which is particularly true for social investment, we are in need of a differentiated definition of social innovation, especially when it comes to analysing innovations such as microfinance[281], crowd funding or "online venture capital"[282] and related areas[283]. For example, under which conditions can we speak of social innovation when farmers receive microfinance for their "regular" farming business?

The growing engagement of commercial banks and profit-oriented corporations in the social economy and in social finance will have to attract researchers' attention. It is commonly accepted that the social finance sector is in need of increasing engagement from these actors. Yet this will shape the future of the sector significantly and have both positive and negative effects on social innovation. Past experiences of 'cherry-picking' by commercial banks – thereby complicating life for social banks – mark a negative example. Thus, it should be of interest how commercial banks' engagement in social innovation could be increased without causing/encouraging cherry-picking and other market distortions.[284] Also, partnering and engaging with financially strong partners, particularly from the corporate world, should receive continuous research attention.[285] In all these aspects, the opportunities and threats should be thoroughly reviewed keeping in mind that increased collaboration between sectors is needed: "Foundations could create guarantee funds that enable a new wave of social investments, banks could provide working capital with philanthropic backing, local governments could issue Human Capital Performance Bonds…This is a time for collaborative entrepreneurship."[286]

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Hypothesis 5: More giving potential in rich societies can be unlocked

At the cross-sections of the social and the human sciences, there is significant potential for generating capital flows. As Singer[287] points out, there is still a vast amount of private giving potential in industrialised countries. If we succeed in better understanding the psychology of giving thereby unlocking at least fractions of this potential, large amounts of capital for social innovation could be generated. And together with online platforms and new technologies – there are now vastly more opportunities for people to give and invest (locally and globally) and for the relationship between grant giver and grant receiver to change quite dramatically (i.e. become closer)[288] – this potential could be unlocked; research needs to be done to find out how. While the dependence of the social economy on grants is debated critically in general, the role of grants and donations for social innovation should potentially be viewed separately. Innovation often involves substantive risk which those actors that could potentially be involved in social innovation may only want to take if there are some 'soft' motivating factors, such as personal biographical and/or emotional involvement in the potential innovation. In this case, grants and donations may be the most suitable, easy way to finance the innovation. Therefore, the potential for innovation of the 'soft' psychological factors should be researched in depth. Particular attention may be given here to demographic trends, with more and more relatively wealthy individuals retiring and/or bequeathing.

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