"GROWING UP TOGETHER: IDEAS AND ACTIONS FOR A BETTER TOMORROW"

Financial instruments for sustainability and growth of social enterprises[1]

Main types of financial instruments[2]

Philanthropy

Many social businesses often start out with some grant funding. It is the cheapest and often easiest source of initial start-up funding for socially mission driven organisations. However, the supply of grant funding is limited, unpredictable and very hard to keep coming year after year. It is very laborious to continuously raise and manage grants. Once your organisation's capital needs exceed a basic minimum, you will wish to diversify into commercial sources of funding – i.e. debt and equity.

Equity

Equity is the most common way for early stage ventures to raise external finance. Raising equity involves selling a percentage of your company to outside investors via shares. The key negotiation with investors will therefore be around the valuation of your venture (i.e. how much your company is worth).

Share capital (equity) is therefore a safer form of capital for ventures to raise than debt because dividends are only paid if the company has the profits to pay them, whereas interest must always be paid – regardless of profits earned….

As a result, equity investors expect a higher return on their investment than debt investors because they are taking higher risk and waiting longer for any payback. Equity investors therefore tend only to invest in companies that they think have excellent growth prospects, where they can receive a multiple of their original investment back (at least 5-10x their original investment within 7 years). This is true even for socially motivated investors, given the high risk they are taking (most equity investments in early stage companies fail within 5 years and the investment will be completely written off).

Debt

Debt for social ventures is typically in the form of a loan from a bank, fund, or direct from wealthy individuals. Unlike equity, debt does not require giving up ownership in your company. Debt is repaid from the cash flows of the company, together with interest, within a specified timeframe (the maturity' of the loan) and according to a specified repayment schedule. If you cannot meet the scheduled payment of interest or principal, you 'default' on the loan, which has the consequence that the loan investor can call in the loan and bring about a bankruptcy of your company. Usually there is a period of negotiation and potentially loan rescheduling and other remedial actions taken before bankruptcy occurs, but if it occurs, it is fatal for the company: the company will be liquidated, its assets sold, and the cash used to repay the loan back first, to the extent that there are any funds left.

The exception to this are start-up convertible loans made to a business in its early stages (seed round and prior). This is a common method of providing start-up capital. In the early rounds of investment, it may be difficult to put a value on the company. A convertible loan is a loan, which can be converted into equity at a later stage, when the company has a more solid track record and a more accurate valuation is possible.

Example of the day: European Social Innovation and Impact Fund [3]

"The added value of social enterprises is clear, but often, getting access to finance is the missing link. This EU-backed fund will connect early-stage social enterprises with investors so the entrepreneurs can get their ideas off the ground. We must keep investing in the social economy, to create jobs, to help improve people's lives and to strengthen our societies' resilience. This is more important than ever in the context of the crisis." **European Commissioner for Jobs and Social Rights, Nicolas Schmit[4]**

- A unique, innovative fund to close the financing gap for early-stage European social enterprises while supporting the ramp-up of social innovation
- Currently the only European impact fund that provides mezzanine capital and is partially secured by a European Investment Fund (EIF) guarantee
- Eminent institutional and private investors committed €4.5 million in capital to the ESIIF at first closing

Европейският фонд за социални иновации и въздействие е партньорство на Европейската комисия и Европейския Инвестиционен фонд с avesco Management GmbH и Financing Agency for Social Entrepreneurship GmbH (FASE). Целта на Фонда е да направи връзка между социални предприятия в ранен етап на развитие и импакт инвеститори, които търсят повече от финансова възвращаемост на ресурсите си.

The European Social Innovation and Impact Fund (ESII) is a partner initiative of the European Commission and the European Investment Fund (EIF), avesco Management GmbH and the Financing Agency for Social Entrepreneurship GmbH (FASE). The Fund aims to connect the social enterprises in their early stage of development with impact investors who seek more than just a financial return of their investments.

The EaSI-Guarantee was granted to the ESII that covers losses of the fund's investment of up to €3.2 million of the fund's target volume of €20 million. The EaSI guarantee, backed by the European Union and implemented by the European Investment Fund, aims to significantly improve the financing ecosystem for social enterprises and, by covering the risk, attract investors who have steered clear of impact investing so far.

The ESIIF offers investors a unique opportunity to participate in social innovations in a sustainable and impactful way that goes beyond making donations. The fund is a closed, special aletnative investment fund under the German law and is intended exclusively for German professional and semi-professional investors. The Fund invests in a diversity of more than 60 innovative social enterprises from all EU member states that work in the areas of education, healthcare, social services and ecology[5] .

Bulgaria: Financial instruments backed with EU funding for social enterprises in Bulgaria[6]

Financial Intermediaries	Type of the financing	Investors focus	Sources of funding
SIS Credit AD	Loan/Guarantee	All sectors/general/startups, early stage, social enterprises	Structural funds – National sources of funding
Microfund AD	Loan/Guarantee	All sectors/general/startups, early stage, social enterprises	Structural funds – National sources of funding
First Investment Bank (Fibank)	Loan/Guarantee	All sectors/general/startups, early stage, social enterprises	Structural funds – National sources of funding

¹ The material is prepared by the Bulgarian Center for Not-for-Profit Law, Pavleta Alexieva, Program director.

² http://socialinvestmenttoolkit.com/wp-content/uploads/2019/03/SIT_Fundamentals.pdf

³ Source: https://ec.europa.eu/commission/presscorner/detail/en/IP_20_2023

⁴ https://ec.europa.eu/commission/presscorner/detail/en/IP_20_2023

⁵ http://esiif.de/en/

⁶https://europa.eu/youreurope/business/finance-funding/getting-funding/access-finance/search/en/financial-intermediaries?shs_term_node_tid_depth=139&field_company_category_tid_i18n=All&field_amount_of_finance_range_value_i18n=All&field_type_of_finance_tid_i18n%5B%5D=2103&field_type_of_finance_tid_i18n%5B%5D=2104&field_investment_focus_tid_i18n%5B%5D=2328&combine=

BULGARIAN CENTER FOR NOT-FOR-PROFIT LAW