Social Investment Strategic Options for Portugal – a focus on social enterprises –

Benchmark Portugal vs. UK and France

September 2014

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ACKNOWLEDGEMENTS

This study was possible due to the contributions of most of the people we spoke to, particularly those in France and the United Kingdom.

We were able to draw on their experience to highlight what was relevant in their point of view (we are thinking of Carole Bazina (CEO, Danone Comunities), Travis Hollingsworth (Director, Big Society Capital) and Nadyal Sattiar (Social Investment Manager, Big Society Capital) and on some of their internal data and reports to have access to otherwise non-available pieces of data (Jean-Luc Perron (CEO, Grameen-Credit Agricole Foundation, and Charu Wilkinson, Project Manager, GHK, thank you).

We went back to them, at multiple times, to check if either our assumptions and understandings were correct and debate logical options (Jean-Michel Lecuyer from CEO, CDI France, in particular).

For all that, and for their patience (particularly Anne Sophie Do (Program Director, CDI, France), we are grateful – as you went beyond what was expectable.

We thank all the 34 institutions that took part in our interviews and focus groups, the participants for openly sharing their views and their respective directions for giving us some valuable hours of their highest level resources .

FOREWORD

Our mandate from the EC has a very clear and tangible outcome which is a business agreement between investors and institutions or entrepreneurs who need investment.

- This mandate dictates a practical and business oriented approach and so what you will find is more something that would be presented to a board as a "new market entry analysis" than a classic academic study.
- As in the "real" business world we took some risks filling information gaps (e.g. the numbers' magnitude and materiality is more important than their 100% accurateness so most numbers on this report will be rounded), we tried to go beyond some accepted truths focusing on the business implications rather than common perception (when we say , for instance, that "there is no ***Social Enterprises Market*** in Portugal", a shock to some, we mean that what there is irrelevant from a sustainable business point of view) , we accepted some experts' statements as fact when there was nothing else and we had no concern for "political correctness".
- Finally, we approached the market as a whole and didn't really focus on its "young" portion as we thought it would mean narrowing further a scope which we found was already narrow to begin with.
- This report is a result of the authors´ analysis. Any mistake or omission is our sole responsibility.
- In the end we hope to have come to a result which is accurate in its facts and figures and actionable in its recommendations. Having said this, we view this document as work in progress and we welcome all constructive suggestions to improve it.
- The Government program within the context of the Portugal 2020 agenda hints at most of the measures we recommend – we expect that these hints will become more specific in the next few months. Hopefully our recommendations will become obsolete in the near future.

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1. Executive Summary

- Since 2006 the French and United Kingdom markets for Social Enterprises have grown dramatically, completely changing the social sector landscape. It now operates in a more sustainable manner, supported by a network of enablers, in an environment that brings social society, civic society, corporate society and government one step closer to working together for a common purpose.

- In Portugal, in the meantime, several scattered well meaning Social Businesses were created but little was done about creating the conditions for a real market to emerge. The Social sector as a whole hasn't fundamentally changed while the environment has deteriorated considerably, driven by the economy crisis.

  In our view, a Social Enterprises market does not exist today as the key drivers for its creation are not in place.

  - However, worthy social institutions of considerable size do exist with the potential for becoming the basis of the market, as long as they show the willingness and ability to grow and the right conditions are created. If they tried, today, they wouldn't be able to
  - Trying to create a market for social enterprises is essentially the same as approaching the problem of financing of the social sector as a whole – with a profitability twist.

- **The scope of this project is to create a platform to finance Social Enterprises. That will not happen unless this becomes attractive to investors.**
  - a number of key drivers have to be put in place:
    - Financial structure, dedicated funds, government push/involvement, legal framework, business capacity building
    - Will and ability of the demand side – even if all the supply side issues are solved, nothing will happen if the demand side reacts in a defensive way and does not embrace change .

  All of this is more important than the financial products side of the question.

- The model we recommend would be to broadly follow the English approach, with a French twist. **We based the individual recommended measures on actual ones implemented in those countries**, with due reference to the country they came from.

2. Glossary and Definitions

2.1 Glossary

BCP: Banco Comercial Português (Commercial Portuguese Bank)

BIS: Banco de Inovação Social (Portuguese Social Innovation Bank)

BPI: Banco Português de Investimento (Investment Portuguese Bank)

BPI: Banque Publique d'Investissement (French)

CDI: Le Comptoir de l'Innovation: (French certified "social enterprise" created in June 2010)

CIC: Community Interest Companies (a statuses of Social Enterprises in the UK)

CSR: Corporate social responsibility

CSS: Cooperatives of Social Solidarity (Portuguese)

EBITDA: Earnings before Interest, Taxes, Depreciation and Amortization

FMCG: Fast Moving Consumer Goods

FUM: Funds Under Management

HNWI: high-net-worth individual

IPSS: Public Institution of Social Solidarity (Portuguese)

IRR: Internal rate of return

MoU: Memorandum of understanding

NGO : Non Governmental organization

ROI : return on investment

SBS: Small Business services (a statuses of Social Enterprises in the UK)

SE: Social Enterprise

SIB: Social Impact Bond

SIFI: Social Investment Finance intermediaries

SME: Small and Medium Enterprises

SSI: Social Solidarity Institution

2.2 Definitions

Big Society Capital: English independent financial institution with a social mission – set up to help grow the social investment market in UK.

Cooperative of Social Solidarity: the same as IPSS (see below) except for the legal status (cooperative in this case).

Equity: A stock or any other security representing an ownership interest in property.

Exit clauses: clauses in a financing contract that define how an investor can leave the venture (fundamental to define profitability and attractiveness to an investor).

Debt: An amount of money borrowed by one party from another.

Private Institution of Social Solidarity (IPSS): a status given to associations and foundations of recognized social worth, in Portugal, that gives access to government social contracts– represents 50% of the turnover of Social Economy.

Quasi-equity: A form of company debt that could also be considered to possess some traits of equity, such as having flexible repayment options or being non-secured by any collateral (a specific asset, such as land or building, pledged as a secondary security by a borrower).

Return on investment (ROI): A typical quantitative measure to define financial performance.

Risk threshold: a non quantitative approach to risk appraisal. The evaluation is based on a judgmental appraisal of different quantitative and qualitative factors.

Seed Capital and Development Capital: the 2 main approaches to view the financing of the (fast) growth of organizations: seed capital finances new businesses and accepts a very high level of risk in exchange for potential explosive growth in some investments. Development capital does not accept the same level of risk, approaches more mature organizations, and accepts lower returns (we are assuming that the final result should be the same).

2.2 Definitions

Social Enterprise (SE): an entity with a double social and financial bottom line. Beyond that, different countries have different definitions, ensuring a broader or narrower view.

Social Impact Bond (SIB): a complex product that ties together private investors and the state to fund a Social Impact project (is typically viewed as the financial Rolls-Royce of social financial products).

Social Impact: getting results out of social outcomes (by opposition with just touching a large volume of people).

Social Innovation: alternative approaches to the traditional ones in terms of financing, managing and treating social issues, thus ensuring (hopefully) better outcomes and more economy/efficiency of means.

Social Investment Finance intermediaries (SIFI): dedicated investor in/to the social sector (typically a fund).

Social Solidarity Institution (SSI): grouping of CSS and IPSS arbitrarily done by us for convenience reasons, as we almost always refer to them together.

Solidarity pension fund: an innovative French pension scheme that allows retail investors to participate in the financing of the social economy.

3. Scope and objectives

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What is the problem we intend to focus on ?

> The EU has realized that Social Enterprises are on the social innovation and social development vectors for the future; and also that different markets are at different maturity levels.

> The issue we intend to focus upon is the development of the Social Enterprises market, within the context of the local constraints.

> To understand the growth logic of the market we will have to understand the drivers that underpin it, namely; competitive constraints, the different frameworks that affect it (e.g. legal and government intervention) and finally the individual degree of readiness of the different actors in this market, be it demand, supply, intermediaries, or the state institutions.

> It is important to stress that we have not focused on the "young" problematic within the scope of this study – as per understanding in the experts workshop (Brussels,26st June 2014).

What is our goal?

> The objective of this project is to **create a MoU to finance Social Enterprises** in a sustainable way,(*) i.e., we are focusing on vehicles that support investments – by opposition to donations – larger than 150k€, be it in equity or debt.

> For that, as per the objective of the project engagement rules, we are looking at creating an agreement between investors which defines a financing platform for Social Enterprises above a given value.

> The main purpose of this report is to look at the objective conditions (those that exist and those that need to be created) that are hampering the market today and need to be changed.

(*) the issue of sustainability is an economic one, as the actual donations levels are unsustainable in the medium-long term

3. Scope and objectives

Caveats

- Generally, country studies on Social Investment and Social Enterprises suffer from a lack of clarity in definitions which translates into confusion in scope.
- The major flaw in most of them is the confusion between Social Economy and Social Enterprises.
- The result is that a lot of analysis on Social Enterprises are in fact on the Social Economy.
- The specific issue of Social Enterprises is that, being a sub-set of the Social Economy as a whole it suffers from the same problems, but adds other, linked to the need for a sustainable financial performance.
- Additionally, even in the specifically 'Social Enterprises' analysis there is a huge discrepancy in the interpretation of data from country to country[(*)]

3. Scope and objectives

Our analysis will be on the Social Investment Market and Social Enterprises

The Social Investment Market – Structure (*)

Demand

Impact-seeking purchasers

- Government procurement of services
- Government as commissioners of outcomes
- Foundations as commissioners of outcomes
- Socially minded consumers of goods and services
- Socially minded corporate purchasers of goods and services

Impact-driven organizations

- Grant-reliant organizations (e.g. charities)
- Grant-funded organizations with trading activities
- **Social enterprises/profit-constrained organizations**
- **Profit with purpose businesses**
- **Businesses setting significant outcomes objectives**

Our scope

Forms of finance

- Secured loans
- Unsecured loans
- Charity bonds
- Social impact bonds
- Quasi equity
- Equity
- Grants

Supply

Channels of impact capital

- Social banks
- Community development finance institutions
- Impact investment fund managers
- Impact investment intermediaries
- Crowd-funding platforms

Sources of impact capital

- Government/ EU investment
- Social investment wholesaler
- Charitable trusts and foundations
- Local funds
- Institutional investors & banks
- Corporate
- High net worth individuals
- Mass retail

Source : Social Impact Investment taskforce G8 (2014)

3. Scope and objectives

Different perspectives define different meanings of "Social Enterprise"

Speaking with interviewees from different countries – and different sensitivities – and looking at the literature, a rather unclear picture emerges.

There is a strong consensus on some core aspects, namely: i) a Social Enterprise should have a double bottom line (financial and social) ii) there is a need for more strict governance accountability and transparency.

The main conclusion is that from a too broad definition (UK government with 283 000 SEs, of which 70000 only are formally SEs) to a too narrow definition (French narrowest definition, with 5300 SEs, in a market of 50 000SEs)– there is a huge margin of interpretation, in multiple parameters. We will therefore use one only definition *(see page 16).*

1. **Distribution of profits**: There are different opinions in how much profit is acceptable and how much is distributable – answers range from 0 to 50%. It depends on the country, legal framework and whom you speak with.
2. **Social mission**: Assuming that profits are accepted, there's a consensus that there should be a double focus: both on financial and social impact results. However, the acceptable trade-off is on a case by case basis.
3. **Donations:** From the point of view of investors, it should not be higher than 20% but could go as high as 40%. Although the English Law (UK SBS definition) allows a ratio of up to 75%.
4. **Democratic and/or participatory governance in decision-processes.** These aspects, though in the letter of the law, are not taken into account in practice.
5. **Return on Investment:** There are no formal limits on ROI, though there are different formal limitations on dividend distribution levels.
6. **Exit clauses:** There are some big differences on the amounts distributable to shareholders–and/or realized in an investor exit; French and Portuguese sources are much more restrictive than UK sources.

3. Scope and objectives

Different perspectives define different meanings of "Social Enterprise"

Point of view: / Dimension:	UK – CIC legal form	UK – government (SBS) definition	UK Investors Interviewed	France Social Law	French Investors Interviewed	Portuguese demand-side actors
Number	9440	From 70000 to 283000		50000		55000(for all of Social Economy). Maybe 100 SEs (less than 100k turnover each)
Distribution of profits	Yes, no more than 35% of the aggregate distribution profits	Yes, should pay no more than 50% of profit or surplus	Yes – through profits and exit clauses	Yes	Yes – essentially through profits AND loan re-payment	No
Return on Investment	-------	--------	15%-to 20% desired 2% true		5% desired 2%true	0%
Asset Lock	Yes	Not required				
Democratic and/or participatory governance in decision-processes	Members and directors are under a stronger obligation to have regard to the wider community and involve stakeholders in its activities than might otherwise be the case	Not explicitly required	irrelevant		irrelevant	Irrelevant
Donations	Up to 30%	Up to 75%	Up to 35%		Up to 25%	N/A
Social Mission	Yes	Yes		Yes	Yes	Yes

Source: HM Government (2014), ICF GHK (2014), INE and Cases (2013)

3. Scope and objectives

We've defined a Social Enterprise according with the same criteria used in practice by Impact Investors we talked to

A social Enterprise is an entity which has a double bottom-line focus, both of social impact and financial sustainability.

This definition is for the scope of this study as we encompass this way the 3 categories defined by the report "Impact Investment: The invisible heart of markets » - Social Impact Investment Taskforce, G8 (2014).

For the purpose of our project we will focus on entities which have a minimum turnover of 1M€ and a level of donations/turnover ideally lower than 20% but could go as high as 40%.

This is implied in the scope definition as we need to be able to invest more than 150k€ (based on a simple rule-of-thumb of implied turnover based on equity levels).

4. Methodology

4. Methodology

In order to identify and evaluate the relevant drivers in each country, we also took a 'top-down' approach

We took a "top-down" approach as there's a lack of:

i) relevant market data, including France and the UK, in Portugal useful factual numeric data is unavailable(*)

ii) standards, Social Enterprise as a concept means different things in different countries

To start with, we based ourselves in our understanding of the problem, by looking for:

i) the typical relevant drivers in market development

ii) the social market specific component idiosyncrasies

We then corrected and completed the first view with the perspective of the different stakeholders collected, on the Portuguese side, through a series of interviews and widely participated focus groups, and what specifically France and UK investors reckon have kick started their respective markets

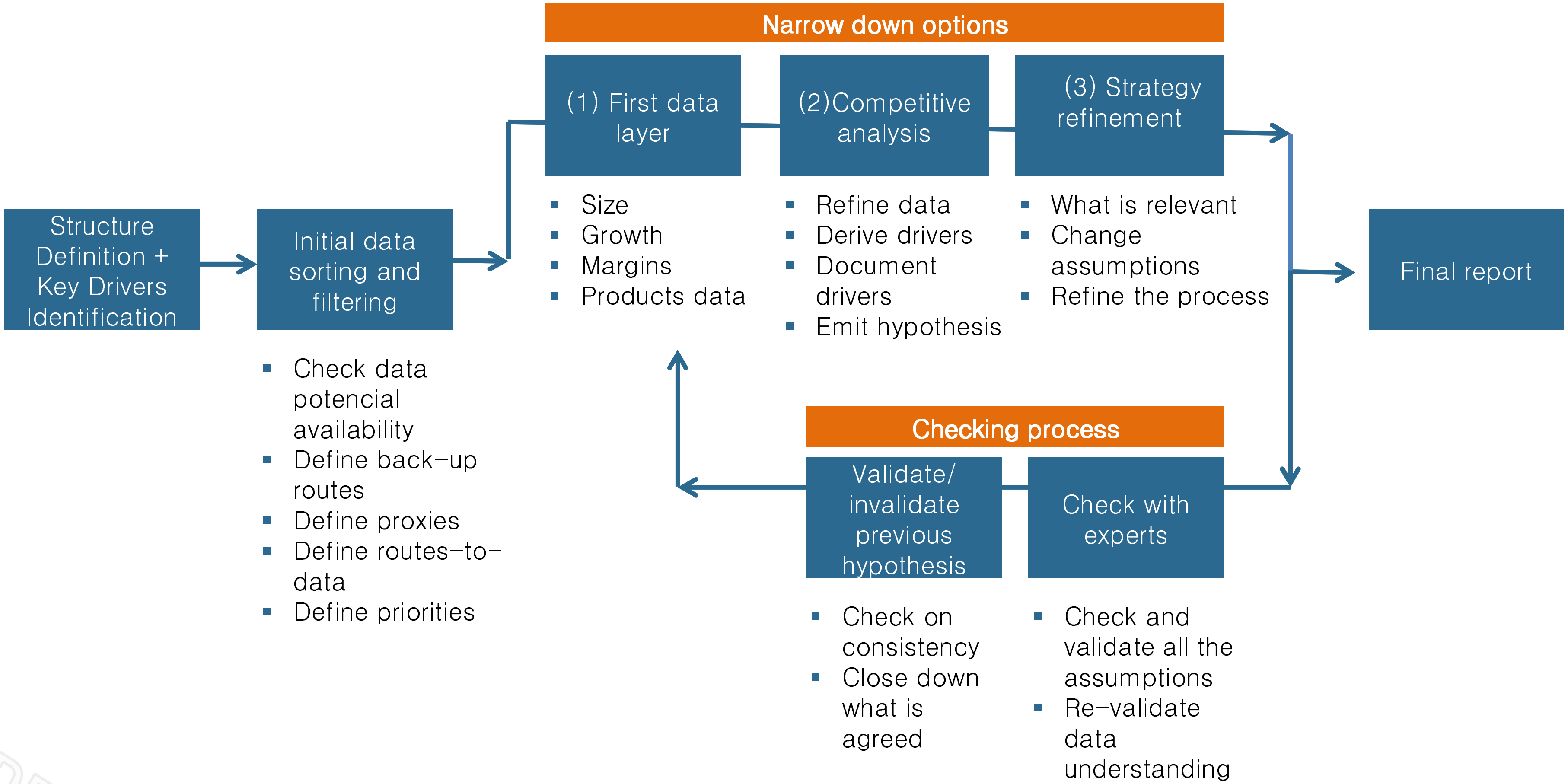
(*) Getting data from government bodies in Portugal is extremely difficult: as a test, we went deep in trying to get 2 pieces of data (turnover and % of donations) for social entities with contracts with the state. The process is still on-going for 2,5 months and mired in different – very relevant – administrative issues.

4. Methodology

We selected France and United Kingdom as our benchmark countries

What do we need?	▪ An historical trajectory, to deeply understand how a country can kick start a nascent market and what are the lessons to learn; ▪ The understanding of how the different market drivers affect the whole narrative, e.g., what does the French "Solidarity Pension Fund" mean to the market – and how it compares to the Big Society Capital role.
Why the United Kingdom and France ?	▪ Both countries are at the forefront of the Social Innovation agenda; ▪ Both countries have different starting points and different trajectories; ▪ Those are the two countries where information is more readily available; ▪ In both countries we were able to have access to relevant actors, such as CDI and Big Society Capital (for example) to validate our understanding of the issues we were confronting.
Why not more countries?	▪ There is a trade-off between knowing a lot about something narrow and knowing little about a larger scope. We chose the first approach; ▪ One cannot understand the narrative of the social institution of a market/country if there's no understanding of the interrelationships between the different market drivers, e.g., how does the legal framework help or hinder the SE development in a given country?

4. Methodology



5. Benchmark

5.1 Benchmark – Identification of key drivers and issues

The conclusion of the interviews with investors to assess the viability and attractiveness of the Social Investment Market encapsulates a set of critical **drivers** and **issues**

Drivers

- Money/funding availability
- Positive legal framework
- Public sector involvement
- Supply-side ability

Additionally, another set of secondary drivers emerges:

- Set of rules/simplicity/transparency/ availability of public data
- Existence of intermediaries/market enablers
- Creation of public tools (for funding, process, and data sharing)
- Capacity building, both financial and knowledge-wise

+

Issues

- Big vs small – of seed capital vs development capital
- Portfolio attractiveness and Cost management
- Need for critical mass
- The risk-return-social impact trade off
- Expected and true profitability
- Debt or equity

4. Benchmark

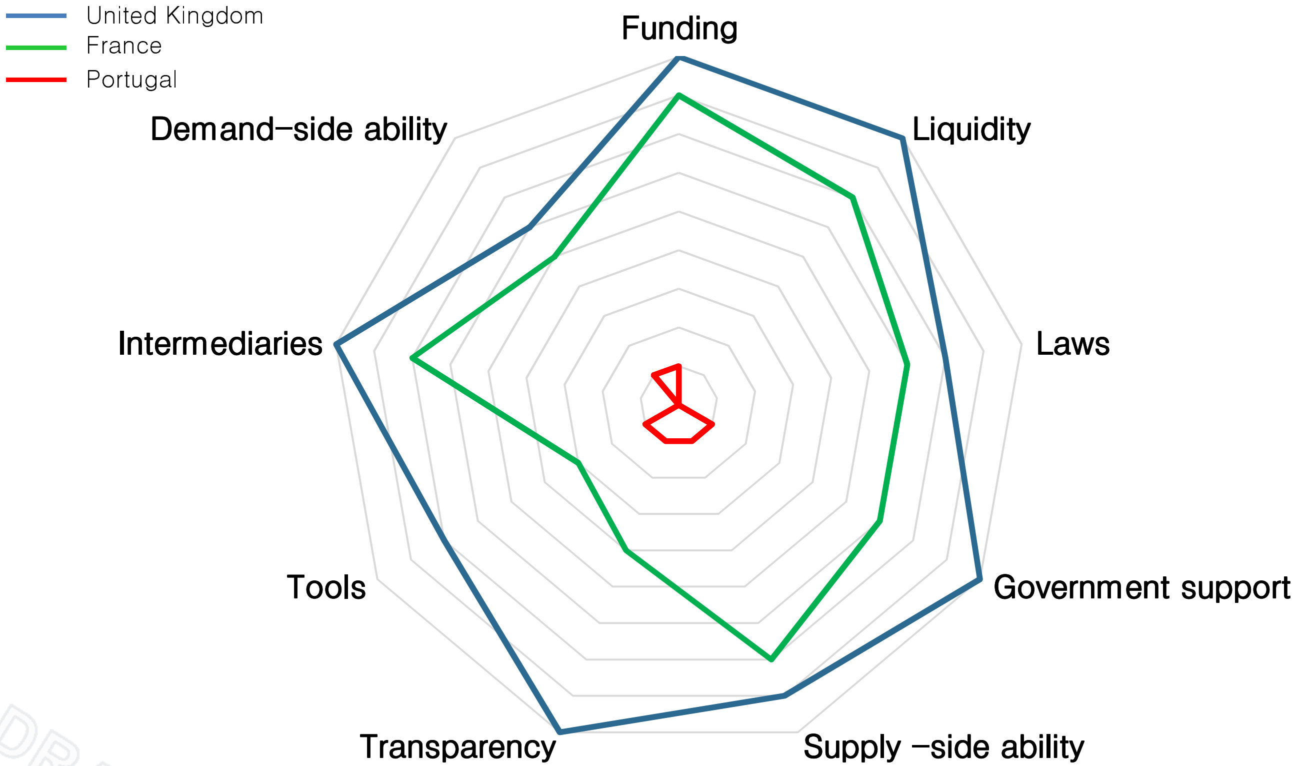
We've identified the 9 critical drivers that investors reckon have kick-started the respective markets

1. **Funding**: origin of the funds, i.e., money available / THE must – in both markets the market was turbo-charged from the moment there was «money available»
2. **Liquidity**: the money that is really used. Directly complementary of the previous driver
3. **Laws**: the legal framework, limiting the way an enterprise can be constituted and operate
4. **Supply side ability**: existence and focus of the different actors of the supply side to support social enterprises
5. **Transparency**: government databases and processes; expectation by investors that enterprises ensure proper governance and accountability
6. **Government support**: Public sector involvement. The actual role of the state as a priority setter explains a lot of the leadership aspects of the UK as a social innovator
7. **Tools**: Creation of public tools (for funding, process, and data sharing)
8. **Intermediaries**: the existence of intermediaries is key to provide special knowledge and rules specific from the social sector
9. **Demand side ability**: capacity building, both financial and knowledge-wise

Investors also consider that the first 5 drivers (funding, liquidity, laws, government support and supply side ability) are of extreme importance, essential "must-have". The others' relative priority could be argued.

5.2 Benchmark – Drivers

We sought the consensus from the UK and France investors' rating of the different critical drivers of the respective markets and compared them with our own findings for the Portuguese market



Conclusions

- **The conditions for the creation of a Social Enterprise market in Portugal are not in place**
- Both the Demand side and Supply of market are lacking
- The UK is the most attractive market among the three
- France also is a strong contender, though it rates much lower in the criteria that relate to transparency, tools and government support
- The picture for Portugal – as it is today – is self-evident in the sense that none of the criteria meets with a satisfactory rating
- We will discuss all of those in detail in the following pages

5.2 Benchmark – Drivers

Funding

- As of today the only funds specifically allocated for social investment are the funds of some trusts
- The stock could be around 3M€. Although the size of the trusts is much bigger, these would be the yearly available funds
- Retail investors have made few and small loans on bilateral deals
- Corporations account for nil in terms of social investment (though they disburse around 150M€ in cash and kind as donations)

UK

- Has a 760M€ government pool of funds specifically allocated (Big Society Capital) to Social investment
- Additionally to that, private funds (SIFIs) have a big pool of money earmarked for this purpose

France

- Has a big pool of funds by retail investors (600M€), through 'Solidarity Pension Funds'
- Further, private funds could add around 250M€ earmarked

Sources: for Portugal : c; for France and the UK : Interviews with France and UK Fund managers; ICF GHK (2014)

5.2 Benchmark – Drivers

Money/ funding availability (Portugal) – details

Money really available

- 500M to 1Bn € – Bank Loans (short –term lending, equivalent to 3 weeks working capital needs)

Money potentially available(*)

- Some Banks: BPI, BCP, CGD, among others
- And some foundations and other Corporations

↓

- For SME venture capital projects

In the very short–term

- Very difficult for a normal social economy entity to get hold of a loan
- Collaterals are typically an issue, low capitalization – or total lack of capital
- No clear rules for SME investment (most funds unused)
- From the perspective of the financing sector, what they see is lack of demand
- No clear interest in funding social ventures (with acceptable capital loss rates – up to 20%)

New products

- Lower interest rate loans
- Intermediary investment funds
- Lower collateral needs loans
- Social Impact Bonds

(*) Potentially means exactly that: technically they have the funds to allocate – which they do today for CSR purposes – what is still undetermined is their readiness to use it in a new way

Sources: for Portugal: team analysis; For France and the UK : Interviews with France and UK Fund managers, ICF GHK (2014) , GHK report on SEs for UK

5.2 Benchmark – Drivers

Money/ funding availability (Portugal) – will the plans for 2015–2020 cover the needs?

PT 2016 ?

PT 2020 ?

New products

- Lower interest rate loans
- Intermediary investment funds
- Lower collateral needs loans
- Social Impact Bonds

The good news

- These products are sorely needed (they do cover a financing gap)
- Particularly intermediary funding loans go for the weakest part of the market – the lack of intermediaries

And the bad news (too early to determine)

Strategically

- Equity funding is not considered
- Only financial products will not solve anything if the different other areas are not tackled:
  - rules, laws, processes
- These products are a good carrot – stick is missing

Operationally

- The details in terms of product design, objective metrics and program governance are not known yet
- Traditionally execution has been the weak link, so we would be tempted to wait before having an opinion. Namely the focus on administrative efficiency measures – for the first time we are looking at having Social Impact, which is not defined as a concept, let alone a working metric

5.2 Benchmark – Drivers

Funding Liquidity and funding: Participation of civil society typically plugs the funding gap (in Portugal), being a major market liquidity driver (as in France)

Portugal:

- Civil society has very limited means to participate financially in the social economy context (by comparison)
- Individuals can use donations as a tax deductible item: this is worth around 10M€/year(*)
- Corporations do contribute with 150M€, but as donations only as they mostly look for emotional "quick gratification". Another reason lies in the fact that the collection of unpaid loans would be a fiduciary and reputational risk
- Otherwise, investments are not in the focus of corporations as social impact is not yet in their agenda (in most cases)
- Which means that Social Enterprises are essentially excluded from being a beneficiary of the civil society
- Finally, HNWI as a whole are basically absent from the donation/investment market – and are thus a huge untapped resource

UK

- The UK is still in the process of developing a market for retail investors to participate in the Social Investment movement – though it is nowhere near as developed as France

France

- In terms of participation of the civil society, France is by far the most developed market, as retail investors are the biggest origin of funds of the social investment market – approximately 60%
- HNWI and corporations also are massively present, through foundations and trusts, and in the case of corporations, with investment funds in their name
- A particularity of France is that a significant share of their investments is made outside of France, namely in Africa and Asia

(*) this is much lower than what would be fiscally efficient for individuals

5.2 Benchmark – Drivers

Liquidity

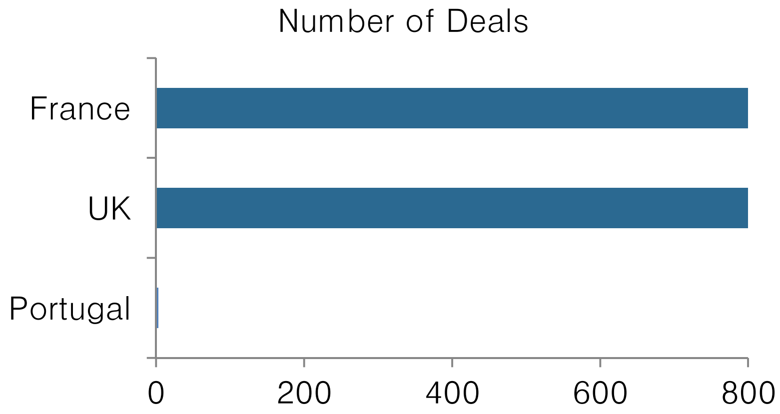
- Very few funds specifically earmarked for social investment purposes. Those that are (trusts) cannot accept the levels of risk associated with seed capital
- Very few initiatives at a development capital level exist – both because of practical and regulatory reasons
- Very few funds are disbursed for equity deals (loan deals also are very few)
- Very small number of financed deals (essentially loans)
- The banking market is essentially off limits (risk rules are applied as standard for other businesses)
- Funds are available for SME-type of development capital

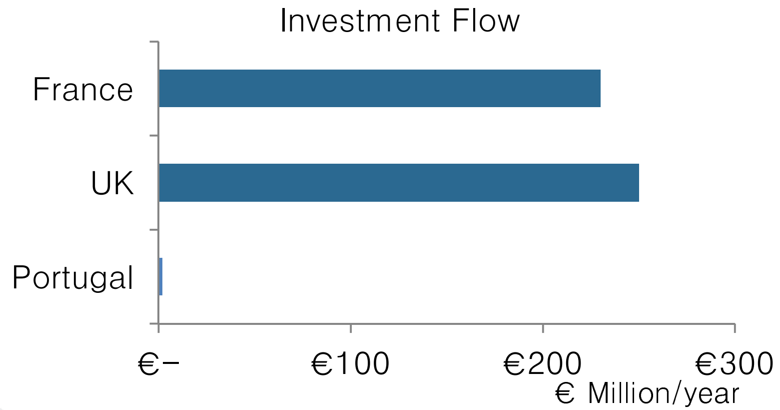
However,
A Big Government program for social investment earmarked for 2015- 2020 (Portugal 2020 Agenda) might make a big difference.

- Both countries have readily available pools of funding for equity and debt purposes
- These funds are used in a high number of debt and equity deals, both for seed and development capital
- Typically 90% would be expected to go for development capital
- These deals are used to further leverage loan deals – the result is that in France the leverage ratio is very high

5.2 Benchmark – Drivers

Liquidity – The portraits of a typical investment in a Social Enterprise in the UK and France are very different from Portugal





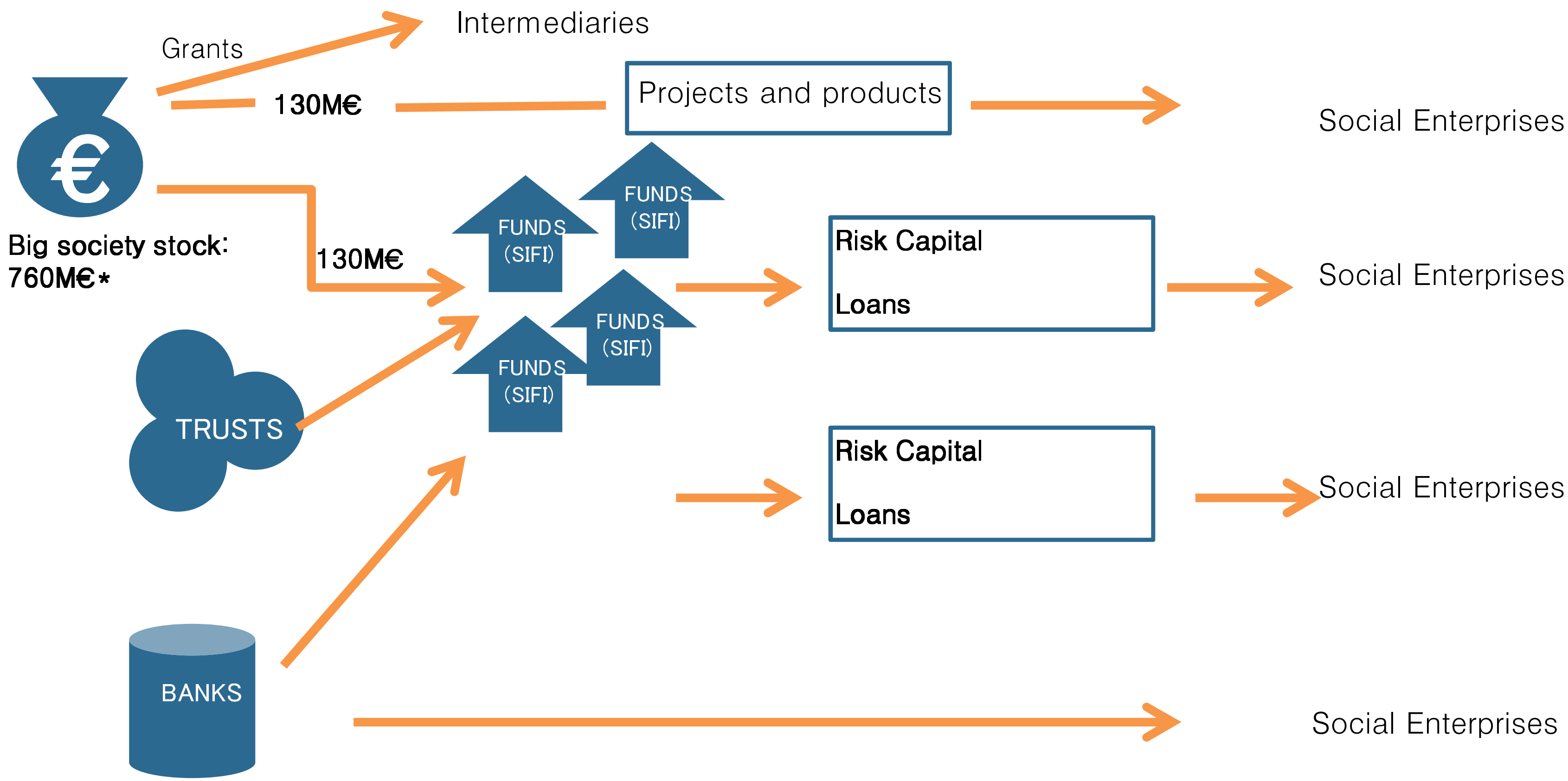
- Both countries, the UK and France, have basically the same figures in terms of total investment, average value per deal and number of deals
- If we consider the market including big and small deals, the average amount per deal in both countries is around 400k€ (whatever mix of debt and equity)
- Big deals, would be typically a mix of debt and equity around 600k€
- Small deals would be a mix of debt and equity up to 100k€ (around 50k€ should be the average)
- We assume that the number of deals is the same between big and small, meaning that 80% of the total investment goes to big deals

There are two types of deals (small and big) typically of equity and loans.
The number of deals and the amount invested are similar in both the UK and France markets. In Portugal, the values are much lower.

Source: Interviews with investment fund managers in the UK and FR; Social Impact Investment taskforce (2014), **ICF GHK (2014)**

5.2 Benchmark – Drivers

Big society reduces the risk and ensures liquidity to the UK market



Big Society is used as both a donor, an indirect investor (through SIFIs and projects) and a financial wholesaler.

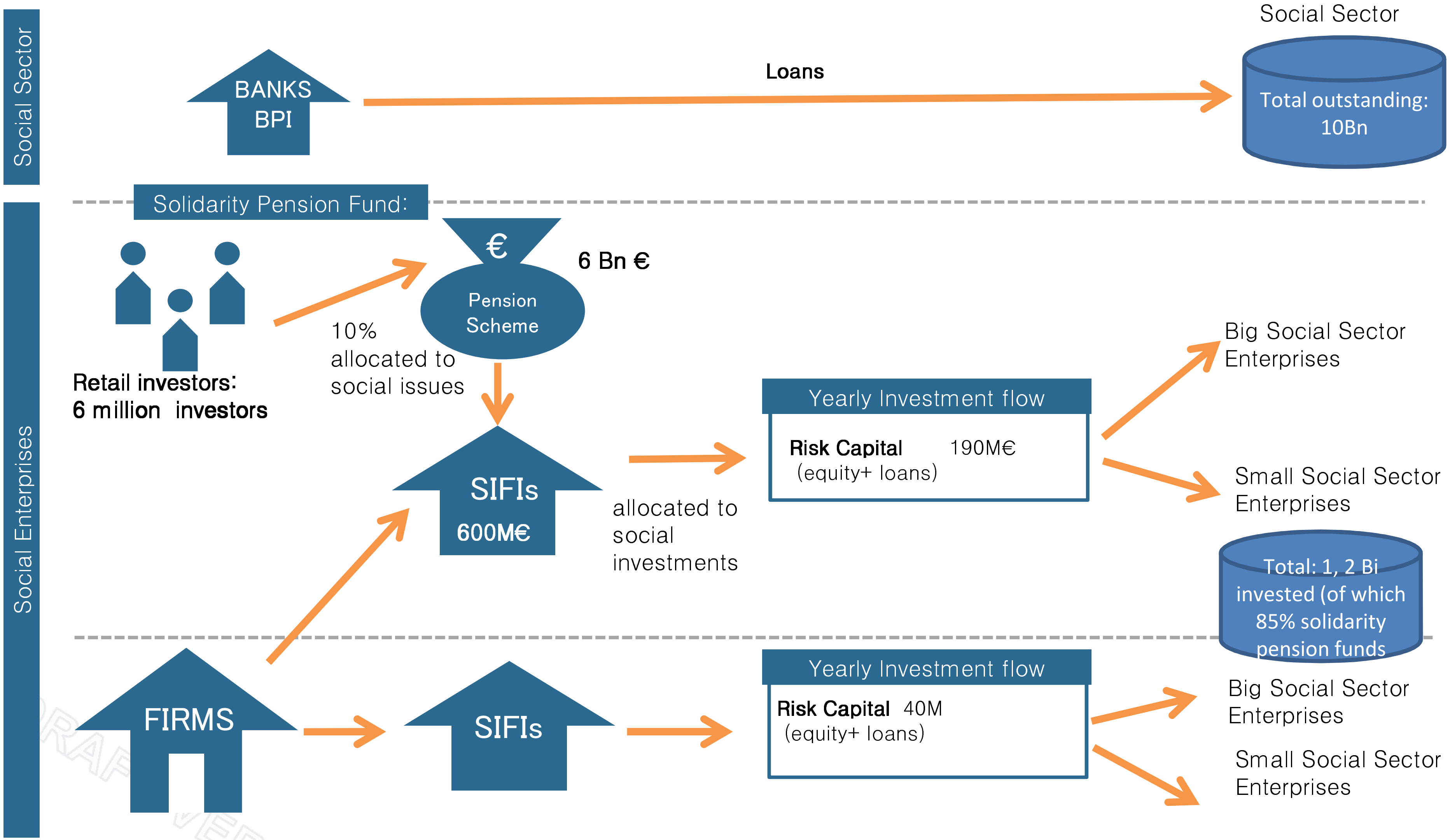
Contrary to France, market liquidity is assured by the definition of "social enterprise". 1) Exit clauses are allowed with higher return rate 2) Any enterprise with social impact with donations up to 60% ensures tax benefits and access to specific financial instruments.

* Currently there are a total of 500M€ Uncommitted.

Sources: ICF GHK (2014) and Social Impact Investment taskforce (2014) and interviews with UK fund managers,

5.2 Benchmark – Drivers

One of the Key Success Factors of the French model is the solidarity pension fund



Source: Interviews with France fund managers,– Finansol reports –JM Lecuyer report – team analysis with the confirmation of CDI, France

5.2 Benchmark – Drivers

Funding pipeline – Portugal – for the social sector as a whole

	Source	Instrument	Amount	Recipient
Stock	Bank	**Microcredit** **Loans** **Guarantees**	50M€ < 500M€ < 500M€	Social Economy
Flow	State	**Services**	1.641M€	SSIs
Flow	Companies w/ Social Responsability	**Donations** •Cash •In- kind	150M€	Social Economy
Flow	Individuals	**Donations**	500M€*	SSIs
Flow	High-net-worth Individuals Crowdfunding	Not significant		

Sources: INE and CASES (2013) and Dunn and Bradstreet (2013)

* Inexistence of official data for this number – Estimated number by team analysis

5.2 Benchmark – Drivers

Laws

- The concept of SE does not exist in the Portuguese law (recently it was negated by parliament)
- What exists is a group of laws governing the social economy entities
- For the SSIs, the 2nd core principle is that the concept of equity does not exist, thus negating any right of governance to any putative investors because they can only invest in a lending form – thus not giving them access to any governance rights
- Also exit clauses concepts do not exist
- It seems that the Social world also lacks awareness of the need for a status change / the advantages that such a status might bring
- Legally, only non-profit organizations can compete for government «social» contracts (health, education, etc)
- Note: Social entities do create for-profit ventures, within their organizations, but based in some cases on voluntary work – i.e. creating a social dumping conundrum
- In other types of contracts, i.e. accessible to profit-oriented organizations, having a social component does not bring any advantages (as opposed to France and the UK)

- In essence the UK and France have similar legal frameworks between them
- They recognize the existence of the concept of SE (embedding the for-profit notion)
- They have a rather broad definition of the concept. They give access to easier financing (both in the form of lower interest rates and lower requirements for collaterals)
- They allow asset-lock, thus protecting the rights of the founders

As a conclusion for Portugal, nothing prevents a SE to be incorporated as a « normal » company with specific internal bylaws, which protects its social vocation. NEVERTHELESS this would put it at a double disadvantage:
–To be excluded from government social bids
–Not to have any competitive advantage in other types of bids (and assuming a competitive disadvantage linked to its double bottom line)

5.2 Benchmark – Drivers

Supply-side ability

In Portugal there are two supply sides alternatives:

- The traditional banking sector, in which some banks have a bigger predisposition to deal with the social sector
  - In this case, social entities, have a more difficult time than a normal company due to their economic vulnerability (lack of profits, lack of capital and collaterals)
- Funds in general, which are essentially part-time actors, focusing on very small deals
  - 80% of the effort is in the buildup to the pitch, i.e., entrepreneurs receive no attention from the moment the deal is structured
  - Most of the operational funding comes from local institutions which have very little interest in scaling up
- Today we do not see a real interest on the creation of sizeable Social Enterprises

This is one of the few cases where it is not clear what the government plans are. That said it is a major blocking point in the market attractiveness

- The consensus from fund managers is that Social Enterprises need a different approach from the traditional venture capital, namely in the following:
  - The need to balance profitability and Social Impact, i.e. accepting typically lower financial returns than for the normal economy (though one could favorably contrast the 2% typical IRR for Social Enterprises to the 2% IRR of venture capital as a whole, in Europe)
  - The need to structure deals to take into account those factors, i.e.: factoring in a higher leverage ratio in order to guarantee a minimal profitability for investors
  - More than anything, **the need to devote a higher share of resources to the post deal follow-up** and development, in all dimensions, financial, coaching and technical and Social Impact expertise
  - It is accepted therefore a much higher cost/FUM, which starts at 4% and can go up to 15% in the case of markets in development (as compared to a typically accepted cap of 1% for normal fund managers)

5.2 Benchmark – Drivers

Government Support

Portugal

- No government support until now
- New government program (Portugal 2020) for 2015–2020 is generically very supportive
- No consensus on concepts (Social Enterprise, Social Investment, Social Impact)
- No online data
- Getting public data is extremely difficult
- Little legislation (in practice inapplicable)

France

- The French government has let the market govern itself (with the exception of recent pieces of legislation)
- Consensus is being created. Example: the bidding process for government contracts has demerits for competitors without social impact
- Little online data
- Each funding site has its own filtering process (for new projects)
- Still very few standards
- New legislation has been approved (21st July 2014)

UK

- The UK government has been for the last 8 years at the forefront of this process, namely in funding and pushing the agenda. Note: it is clear from the discussions that it is the government agenda which is pushing the envelope and setting the pace
- There is a clear consensus on rules and common definitions (social impact, what is a social business, money/profit vs. social return)
- Data-access is a given. Easy access
- Process rules are transparent. Calls are public and online
- Clear legislation

5.2 Benchmark – Drivers

Intermediaries

- Intermediaries are basically in embryo stage in Portugal
- Very few social impact evaluators, no database providers, etc
- The reason for that is manifold:
  - i) until now public funding was not accessible to fund intermediaries (for example a business case consultancy was not eligible for funding)
  - ii) corporations have until now insisted on going directly to the social providers dispersing their donations and not giving importance to services such as Impact Evaluation
  - iii) in the case of the government, Social Impact evaluation is a nice to have element, treated as a separate project – to be funded by somebody else
  - iv) the focus of existing intermediaries on seed-capital related projects

However,
There is a silver lining, though as the Government has recognized in its Portugal 2020 Program there is a need to support the intermediary market.

- The existence of an intermediary market is regarded by most fund managers as critical
- The rationale for that is based on the assumption that the traditional market is not equipped to deal with the double-bottom-line issues
- Both France and the UK have a well developed market in terms of raters, info givers, database providers, financial brokers/funds, social impact evaluators and other forms of consultants
- They regard as critical "first-step" the existence of funding for the intermediary market
- In France and the UK the intermediate market is funded by public and private funding (with a sum of the critical ones being deep pocket funded by some of the pivotal funding institutions). The market is also disseminated by the assumption that a lot of the work has to be done by intermediaries

5.2 Benchmark – Drivers

Demand–side ability

- The Portuguese Social Sector faces a difficult challenge due to the economic crises while not changing its business model

- In the case of major actors, though they accept that the old model is under pressure, they insist on keeping all of its facets
  i) the non–profit model
  ii) doing as before
  iii) little delegation – as most boards want to retain absolute control over their way of doing things

↓

- By doing that they are not pursuing alternative routes
  i) the consolidation route
  ii) the expansion route
  iii) financial and/or services diversification

- However, in most cases, the issue is more of lack of basic management skills/business capabilities

- This topic has elicited consensus between fund managers of France and the UK, namely that "there still is a lot to be done in their own countries"

- The obstacles they point out are multiple and common to all countries, eventually in different shades of grey

  i) Psychological blockages – for example, reluctance of French civil society in accepting exit clauses that benefit investors in the social investment market

  ii) Capacity: the recognition that Social Enterprises, by their own nature, lack management skills which have to improve

  iii) Willingness and awareness: a lot has been done – the proof being in the evolution towards the SE format of a substantial part of the Social Economy of the 2 countries

- At no point, though, have issues related to democratic management been raised

5.3 Benchmark – Issues

Big Vs. Small Investments – the need to separate development and seed capital

- From a purely business (and social business) point of view, the question remains of which of the two targets is the most efficient vehicle to increase Social Impact
- The "BIG" (development capital) option means taking an existing entity, which is big enough to already have critical mass to operate in an efficient way and with a proven business model which effectively deals with the social issue it is dedicated to, and scale it by increasing its reach (geographically, by just increasing their capacity or other).
- The "SMALL" (seed capital) option means to take what looks like a good idea (generally innovative, thus unproven) and start developing it from scratch, which involves a much higher statistical risk – even more so in the social world.
- The "Business World" spends the vast majority of its resources on developing and expanding proven business models, growing in a more or less fast and sustained way. Really good companies also spend a reasonable amount of their resources scouting for somebody else's ideas to copy as a low risk path to innovation. Very few allocate a big part of their resources to developing in-house THE IDEA that is going to change the world as we know it, bringing exploding returns before it is copied by somebody else. It is an expensive, slow (2 years is the average for FMCG products, much more for technological or pharmaceutical) and generally painful process as the vast majority of the developments never sees the light of day.
- Finding the right mix for this resource allocation is where top managers spend a significant part of their efforts.
- Something all good businesses do, however, is collect the "low hanging fruit" (the quickest results which require the least effort) before they move up to higher branches.

5.3 Benchmark – Issues

Big Vs. Small Investments – the need to separate development and seed capital

Big

- Development capital
- Typical investment value: 500k€
- Investment mix : 50/50 equity and debt

(Development capital, typical investment value and investment mix: in the case of a first round of investment)

- Turnover : more than 2M€
- Risk perceived : low, there is already a track record
- Growth expected: medium/low
- Need to focus on coaching, social impact techniques and scaling
- Investors: SIFIs and foundations
- Cost of portfolio management: nominally 2%, real 7 to 10%
- Portfolio IRR: 0% to 2%

Small

- Seed capital
- Typical investment value: 50k€
- Investment mix: debt and equity
- Turnover : 100k€ to 500k€
- Risk perceived: very high – no track record
- Growth expected: must be explosive (low growth small investments are not even to be considered)
- Big effort on pre-pitching – and prototyping
- Investors: dedicated business angels/ incubators (i.e., very rarely SIFIs)
- Portfolio IRR: very negative (-20%)

The operational focus and skills for small and big deals are different

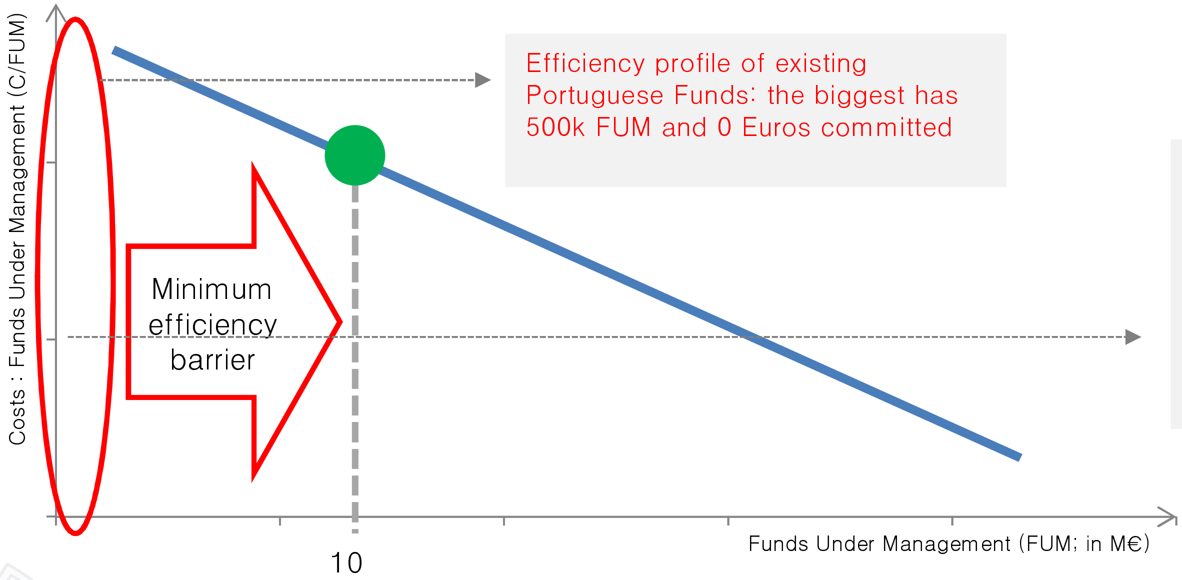
Sources: Interviews with investment fund managers in the UK and FR and team analysis

5.3 Benchmark – Issues

Portfolio investment management – the need for a "benefactor" and "the race for size"

> One of the un-written truths about the Social Impact/Social Investment portfolios is that they are «in the red» when all costs are computed: though the nominal returns of 2% IRR are the consensus on declared profitability – this is based on pre-inflation figures and does not include typical management costs

> Typical management costs in this industry are much higher than for venture capital, and understandably so: the need for support of a growing SE is much higher, in all aspects, than a typical «growth venture investment». In most cases the true management costs are supported by a «benefactor», i.e. an entity which one way or the other allows you to assume costs that otherwise would ruin the projects financials



A typical Mutual Fund is considered efficient when the ratio C: FUM ≤ to 1%

However, a Social Investment Fund can go to 3% and 4% within acceptable efficiency boundaries

For illustration purposes, we assume a value of 400k€ as the total management cost per year of a Social Investment Fund. Taking into account the 4% ratio C/FUM we conclude that the Funds Under Management must be 10M€

*only for illustrative purposes. Not drawn to scale
Source: interviews with investment fund managers in the UK and FR

5.3 Benchmark – Issues

The market need for a "benefactor" entity that finances market–development critical entities

- Both The Uk and France markets have Benefactors embedded in their structure – in Portugal that has not sunk in, yet, although the Portuguese 2020 Program mentions the creation of a «Social Investment Fund» which could play that part in the same way Big Society Capital does in the UK
- There is a consensus that beyond the difficulty of growing a double bottom line, SE profitability is problematic at best
- It is also consensual that the market would not grow at the same pace if some actors were not to finance the market development work
- In the end it is accepted that part of the grants money should be re–directed to grants for market development

↓

- In Portugal these is a politically difficult message to sell, namely because it will involve transferring funding from the causes to the structure of the market

Examples of Benefactor

- In the UK, Big Lottery is financing Social Finance: as such 75% of revenues of Social Finance come from a yearly grant, without which it would not be able to do the market development and R/D work it does
- In France, CDI is helped by its belonging to the SOS Group: as such it benefits from access to hundreds of specialists which allows the portfolio support work costs to stay within financial constraints
- Also in France, in the case of the Danone Grameen Fund, all the technical costs, which could represent 75%(*) of the portfolio committed funds, are bourne by the mother company Danone

(*) for a 5 years period

5.3 Benchmark – Issues

The rationale for having an «instrument» such as Big Society Capital(*) is manifold

- **It allows for a pool of funds to exist – out of the scope of traditional banks**
  i) the issue about the pool of funds, as already said, is that it gives a signal to society that there is specifically allocated funding for the purpose of financing projects and entities «with a view for Social Impact»
  – in the case of the 760M€ of Big Society Capital (of which only 260M€ are committed) come from unallocated assets in all the UK banks and allow for a long view of the market development

  ii) the other point is not to mix it with traditional banks, for several reasons:
  – the existing conflict of interests
  – the skills needed go beyond the traditional financial know-how (which would explain for example why the French BPI has had so much trouble in financing the social sector/enterprises)

- **It allows for a mandate to exist to develop a market with different « approaches »**
  i) different objectives have to be pursued at the same time, with different financial characteristics:
  – a wholesaler to finance the intermediaries who effectively fund the projects (in this case a number of SIFIs draw their financing from Big Society Capital lines of credit)
  – an actor to fund innovative approaches – such as SIBs– which for different reasons would be beyond the reach of traditional banks or foundations, due to risk considerations – or other
  – an actor who can directly fund specific lines of work that lead to the market development
  In this case Big Society Capital is the main backer of Social Finance – on a grant basis

- **It allows the funding of high risk operations with exceptional Social Impact potential that otherwise wouldn't see the light of day**

(*) one could raise the issue why Big Society Capital, when the French market does not have such an instrument: the answer would be that would help explain why the French market has more liquidity issues than the UK market – which are partially compensated by the access to solidarity pension funds.

5.3 Benchmark – Issues

Critical Mass – a demand or supply issue?

Portugal

- Portugal has a solidarity sector which is very fragmented (the number of charities/NGOs, etc is the same as in Spain, which has 4 times the population)
- As in every other market there is a natural defensiveness re consolidation
- Major social issues have an inefficient social response (e.g.: overlapping efforts on the same subject/neighborhood)
- There are few scalability solutions (e.g.: an idea that works in a city will not necessarily be replicated to another city)
- Additionally the small size of most entities make them economically unsustainable and/or technically unable to meet management demands
- From the supply side the same happens: funds that could be used for social entrepreneurship are capped (in practice, in most cases) at around 10k per deal and they are not structured to deal with seed capital (i.e. the investment requirements have more to do with development capital, in terms of risk acceptance)
- Also, neither funds nor banks are equipped to go beyond the funding process, as such ventures die out after the first 2 years – namely due to lack of extra funding and management support

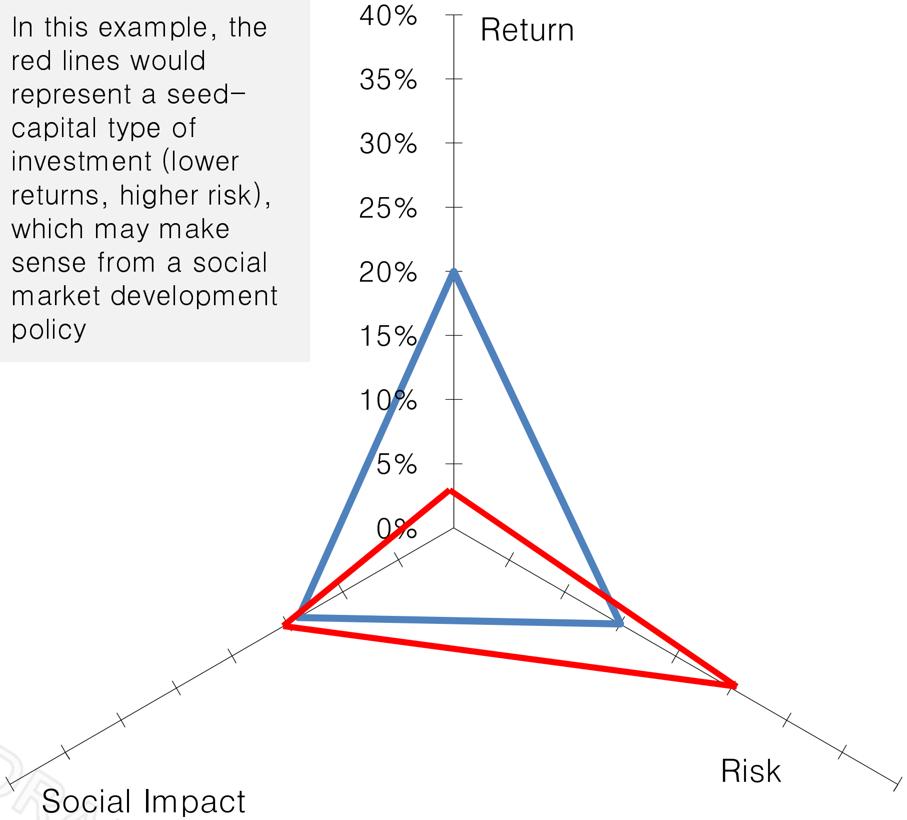
UK and France

- Both France and the UK have recognized that there is an added value in reaching critical mass
- The market share of the top decile is bigger than 50% (though fragmented at the bottom end)
- Bigger SEs have formal competitive advantages in bidding processes
- Investment processes are structured in a way that smaller entities end up being excluded from the process

5.3 Benchmark – Issues

Profitability – expected and true

In this example, the red lines would represent a seed-capital type of investment (lower returns, higher risk), which may make sense from a social market development policy



Return

1) Acceptable Return Rates ranges from -5% to 30%;
2) The typical target would be between 0% and 10%;
3) The average ROI on portfolios on big deals would be around 2%;
4) The same portfolio can have different IRRs for different classes of assets: i.e. +5% in general and -20% for seed capital (as long as the weighted profitability is within the target and within risk limits).

Risk

1) Risk is seen as a stopgap mechanism;
2) There is no quantitative reference level but investors will not go beyond the market risk level, *ceteris paribus;*
3) *The exception will be seed-capital which may benefit to be blended in a lower risk portfolio.*

Social Impact

1) There is also no quantitative reference level;
2) However, lower returns are accepted in case of higher social impact projects.

* The blue line is only for illustrative purposes. Not representative of any specific portfolio

5.3 Benchmark – Issues

Debt or equity?

- The discussion between debt and equity has different aspects as seen from the point of view of investors and managers, in fact the issue should include the discussion of quasi-equity

	Equity	Quasi-equity	Debt
Seed Capital	Is an absolute must as it gives access to bank financing		Can be given by the bank Can also be a way to ensure a minimum profitability to investors Still, the big majority of small deals are structured with debt
Development capital	Equity has big advantages but it adds a layer of complexity, which is difficult to manage in the case of a portfolio – namely the exit strategy of the investors (i.e.: sell to whom in the exit?) ↓ This is the reason why smaller deals are structured around debt, which is more flexible	Quasi equity (i.e. subordinated debt, or investment titles) is a way for non-equity rich SEs to overcome legal or other limitations It also gives a bigger repayment flexibility, while adding to their leverage capacity	

6. Portuguese Market Analysis

6. Portuguese Market Analysis

Understanding the Portuguese Market

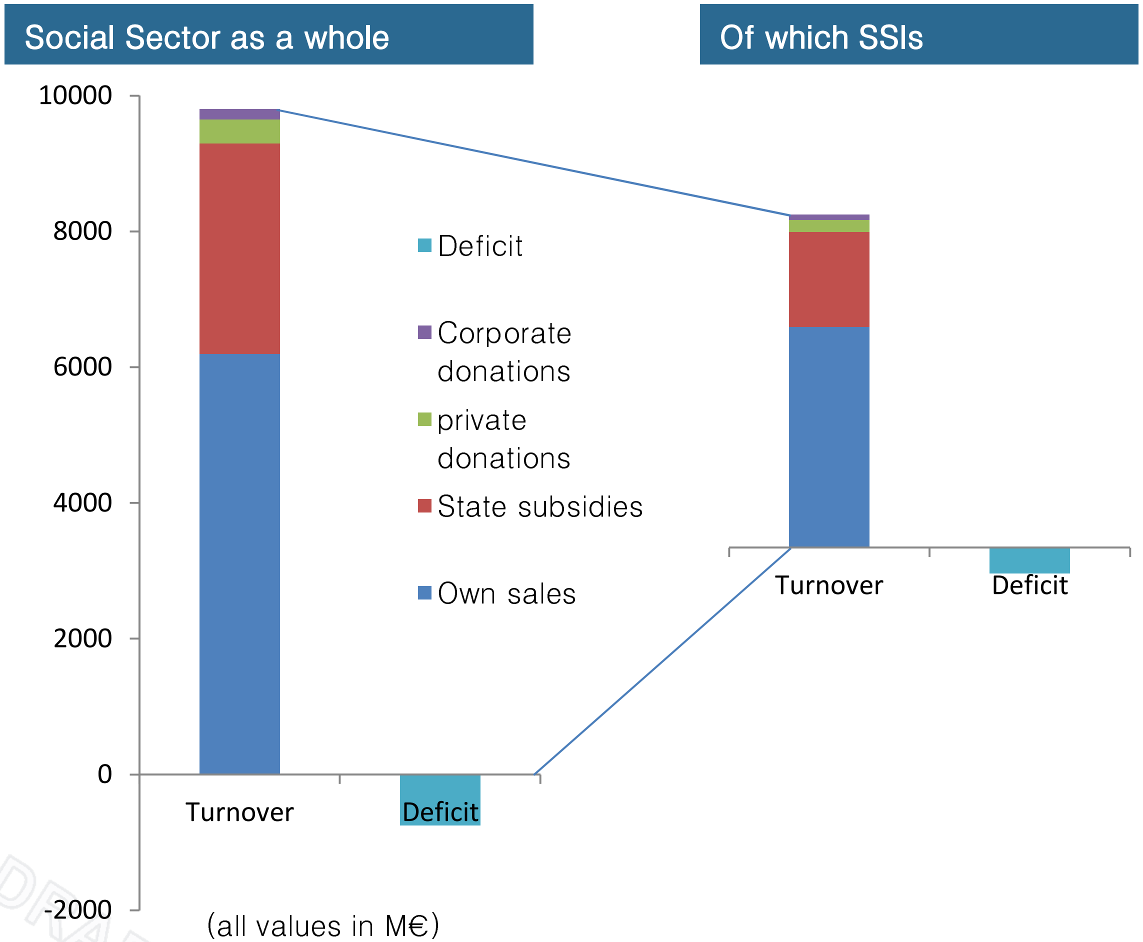
- From a macro standpoint, the social sector has been starved for funds: we are talking of a funding gap of around 750M€ yearly i.e., the pension gap is being funded with taxes and social benefit payments (mostly because of unemployment) have soared in detriment of social policies. In the current state of the market civil society cannot be counted upon to bridge even part of the gap as there are no incentives to do so, either legal, fiscal or practical. However, there is a huge – largely – untapped market (when you compare, within due proportions , to what happens in France). Moreover, a big share of the turnover – actual or potential – comes from the sales of services to government agencies. The price for these services is tabled (the same for everyone for a given type of service) and mostly cost dependent – efficacy and social impact criteria are absent from the whole bidding to management process

- Strategically the investment option raises the issue of 'uncovering the feet to protect the head' : how can public funds be refocused without lowering the social net standards in the policies that exist?

Sources: INE and CASES (2013) – Analysis of the Conta satelite accounts

6. Portuguese Market Analysis

The Social Sector has a funding deficit – SSIs share a big part of the problem



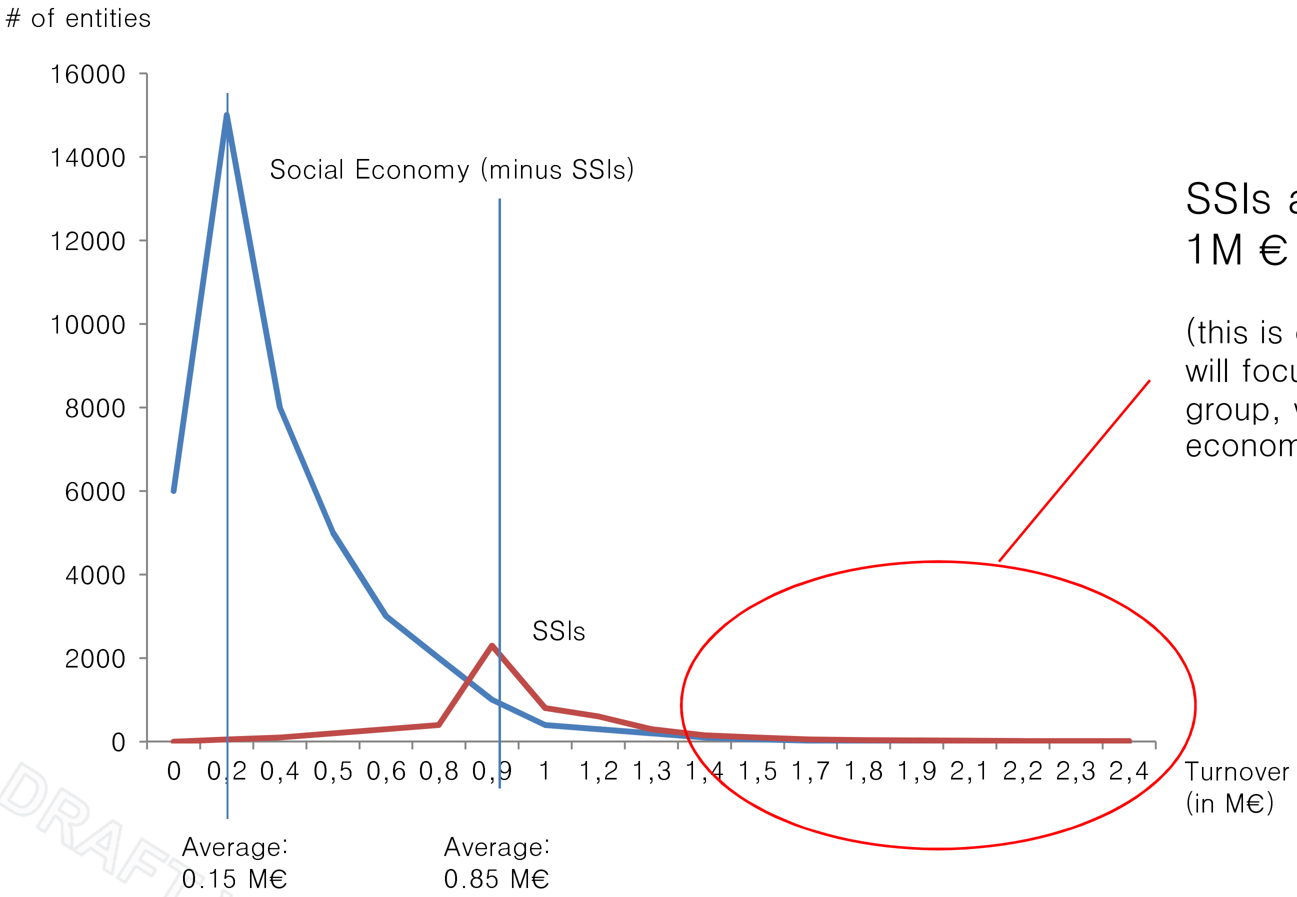
The Social Entreprise approach could be used, as in the UK and France, as a way to plug the gap in the Social economy finances

(We will focus from now on on the SSIs group, which seems to offer better economic viability prospects)

Source: NE and CASES (2013) – Analysis of the Conta Satelite accounts
Methodology : we expurged non-social activities and extrapolated some data from other sources (eg : data on corporate donations from Dunn and Bradstreet)
We do admit that these figures may have a certain amount of error, namely due to the fact that we use data from different years and/or sources

6. Portuguese Market Analysis

The focus on SSI is based first on a statistical approach: they are the “low hanging fruit” of what could be viable prospects of future Social Enterprises



SSIs are predominant in the 1M € + turnover «area»

(this is one of the reasons why we will focus from now on on the SSIs group, which seems to offer better economic viability propects)

6. Portuguese Market Analysis

Legal Framework Comparison

Social Enterprise	UK	FR	PT Not–for–profit	PT For–profit
Allows for profit?	✓	✓	X	✓
Public/Government bids?	✓	✓	✓	X
Any Government financial support?	✓	✓	✓	X
Social Purpose?	✓	✓	✓	✓
Are certain activities excluded from companies that want to be social enterprises?	✓	✓	✓	N/A
Limitations to the transfer/distribution of assets?	✓	✓	✓	✓
Cap limits to dividends and interest?	✓	✓	N/A	✓
Performance related interest cap?	✓	?	X	N/A
Allocation of part of its annual revenue to the constitution of a legal reserve?	X	✓	✓	✓
Additional statutory obligations?	✓	✓	N/A	✓
Limitations on the pay of Board Members?	✓	✓	✓	✓
Involvement of stakeholders required/encouraged?	✓	X	✓	✓
Specific organisational structure/management requirements?	✓	✓	✓	✓
Additional obligations at the incorporation stage?	✓	✓	N/A	X
Extra clauses required in the Articles of Association?	✓	X	N/A	✓
Additional fees?	✓	X	N/A	X
Special Tax Status?	X	X	X	X

6. Portuguese Market Analysis

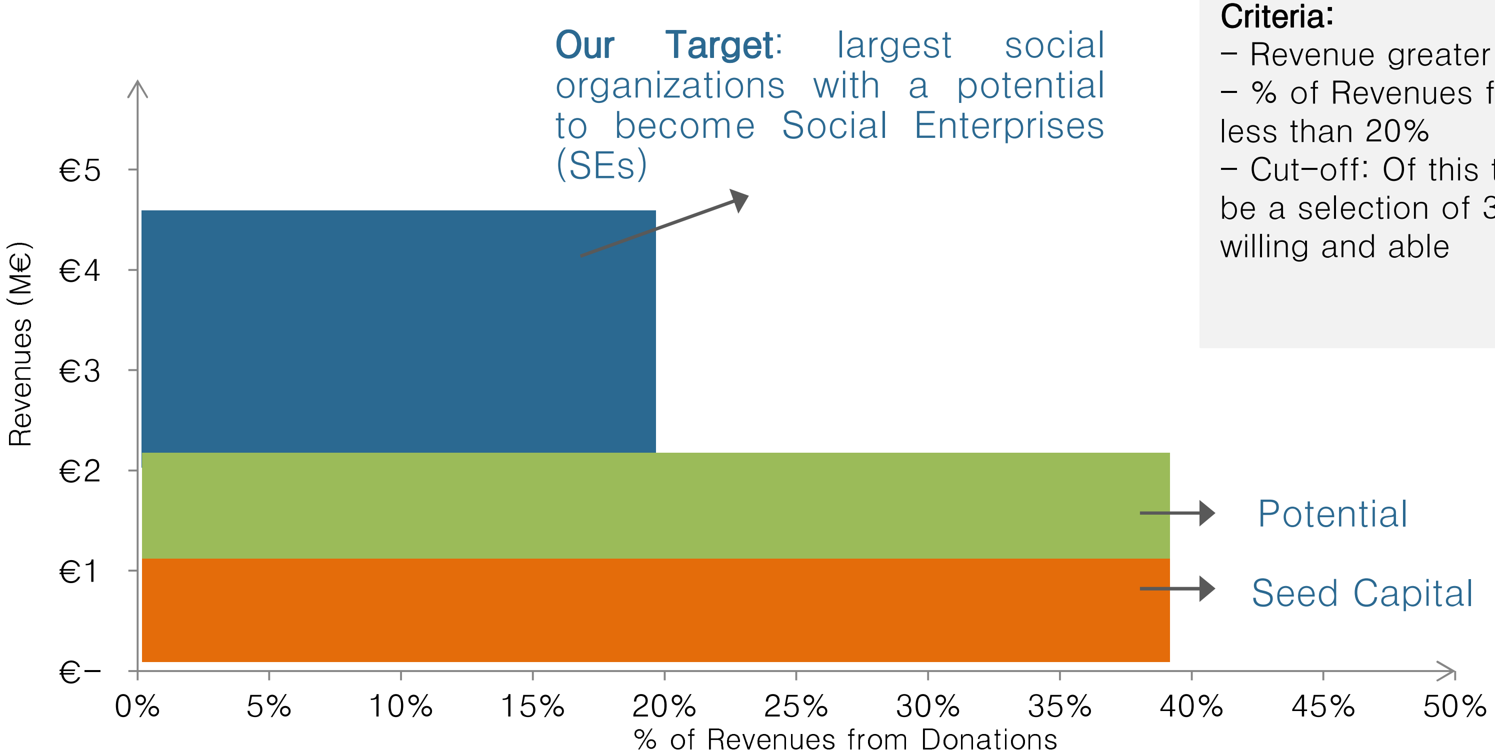
Legal Framework Comparison: there are critical features in the UK and France enterprises, not possible in Portugal

SOCIAL ENTERPRISE	UK	FR	PT NOT-FOR-PROFIT	PT FOR-PROFIT
Allows for profit?	✓	✓	X	✓
Public/Government bids?	✓	✓	✓	X
Any Government financial support?	✓	✓	✓	X

- The 3 issues above are the ones considered critical to define a SE within the context of a "social law"
- On one hand, the legal concept of "social enterprise" does not exist. In Portugal a social sector organization (associations, foundations and cooperatives) can only be a non-profit structure according to the Law on Social and Solidarity Economy. A social sector organization can share many of the features of a "social enterprise" in the UK and France. However, not the most important one: it is not allowed to have profits
- Last, these statuses, within the Portuguese context, do not allow for equity funding which strongly limits the funding abilities and the attractiveness of these institutions to any outside investor
- On the other hand, some of the "social enterprise" main features, such as established in the UK and French legislation, could be introduced in Portugal in the context of a for-profit (normal) corporation through its by-laws. However, that enterprise would not be able to either receive any financial support from the government not to apply to the public bids (which in fact would close a substantial part of their current business)

6. Portuguese Market Analysis

Our criteria to select the target market is the same that impact investors use in practice



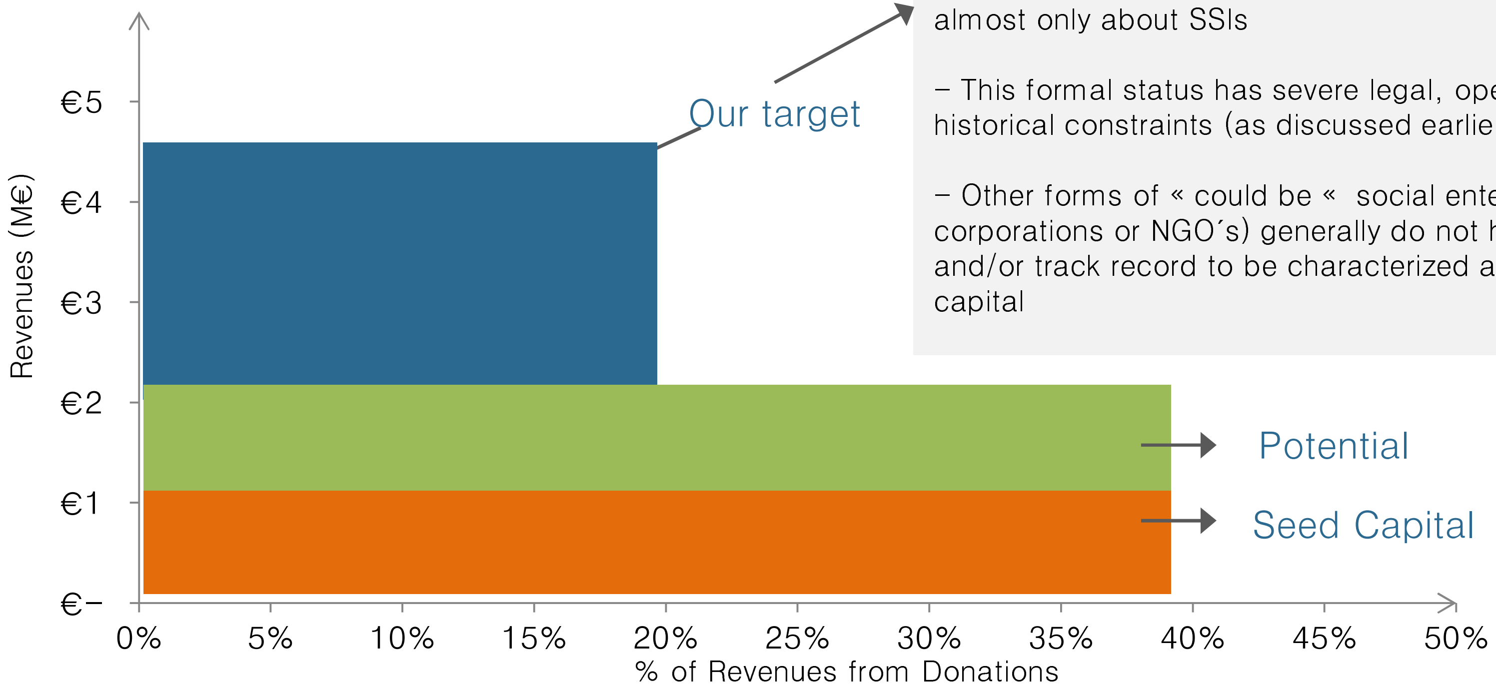
Criteria:
- Revenue greater than 2M€
- % of Revenues from donations less than 20%
- Cut-off: Of this target there will be a selection of 30% of those willing and able

- The first screening to select the target market is based on quantitative criteria. Only afterwards, social impact is taken into consideration.
- investors in seed capital are not the same as the investors in development capital.

*Interviews with investment fund managers in the UK and FR and team analyisis

6. Portuguese Market Analysis

Our focus will be in investments in Social Enterprises that can handle 150K€ + inflows (either in equity or debt)



Constraints: Due to the size constraints (we need to target entities with more than 1M€yearly turnover), we are talking almost only about SSIs

– This formal status has severe legal, operational and historical constraints (as discussed earlier in the legal part)

– Other forms of « could be « social enterprises (normal corporations or NGO´s) generally do not have the size and/or track record to be characterized as development capital

We will have to identify the ones that are scalable. All manners of blockages will have to be removed (or surpassed) before they can evolve to Social Enterprises

*Interviews with investment fund managers in the UK and FR

6. Portuguese Market Analysis

IPSSs and CSSs are "private non profit institutions constituted with the purpose of giving organized expression to the moral duty of solidarity and justice among individuals". They form the backbone of civil solidarity and are very close to the EU concept of Social Business

- Technically it is a status given to social entities of recognized social worth that allows them to establish protocols with the social security institutions (*) for the sale of social services (which are generally perceived by both sides as "subsidies"):
- Approximately 5100 institutions, with an average turnover of 850k€ –but the top 100 have a 2M€+ turnover
- They have business models recognized by the government and as such they are funded by the state through the sale of services (e.g .a bed costs x euros per night), by their own sales to other entities and by donations
- They are focused on major social problems as defined by the government, e.g. health and care to the needed, integration/reintegration of the socially excluded, handicapped population, child care.
- They generally have the technical capacity to develop their social missions
- They generally lack business skills
- Many are still managed by their original founders
- Typically they do not own most of their assets (truer in the case of IPSS)

- The whole point of this document is based on the premise that these should be viewed as the most viable potential future SEs.
- As such we will explore the necessary mechanisms and impediments for that to happen

(*) there is a further analysis of the legal implications of being an SSI

6. Portuguese Market Analysis

Only one of the existing funds is targeting impact investment – all the rest give grants to social projects

Fund Name	Amount disbursed per year	FUM	Observations
BIS (SCML –Santa Casa Misericórdia de Lisboa)	0€	500k€	In 3 years it hasn´t made any disbursement. It seeks to fund small social projects.
Bolsa de Valores Sociais	100k€	240k€	It is a social donations platform. It is being revived.
Fundo Bem Comum (ACEGE – Associação Cristã de Empresários e Gestores)	100k€	2.5M€	Venture capital fund, not targeted for social enterprises nor social economy. Difficulty in finding suitable projects.
Lets Help	0€	30-60K€	Part-time team. Dedicated to micro projects.
Fundação Mais	50K€ (TBC)	1M€	It is the only fund targeting specifically social enterprises. Has only found 2 suitable ventures. It is a seed capital fund.
Other Business angels /Seed capital	20K€		No business angels targeting social projects nor funding them. Most venture capital and business angels focus on tourism, health and high tech ventures. The few social projects that have been funded received on average 10k€.

- Very little seed capital exists. Even in the wider social economy context, the amounts disbursed are too small to have social impact (10k€ per deal on average)

Sources: desk research and Focus Groups output

6. Portuguese Market Analysis

Existing financial products

Products used	Value	Who/ scope	issues
Normal banking loan		From banks	▪ limited by the lack of collaterals (most social entities do not own a lot of assets) ▪ In most cases risk is seen as high due to low economic « sustainability » ▪ collections can be problematic for reputational reasons ▪ normal enterprises do not do it for prudential reasons (they can be accused of dereliction of duty if they fail to repossess a loan)
Overdraft facilities		Banks	▪ the most used product
Private loans	Very low (– 500k€ yearly)	Bilateral agreement	▪ It is a bilateral loan agreement between the social entity and any type of lender. ▪ typically it would entail a yearly interest payment and a final balloon payment ▪ whatever the size it does not give any right of regards in the governance of the institution
Grants/ donations	350M€ private citizens 150M€ corporations	Private citizens Corporations	▪ the most popular instrument used by private actors ▪ there are fiscal advantages (see pages on legal/fiscal issues) ▪ there is not a savings mechanism to transfer donations into investments (as per solidarity pension schemes in France)
Equity	100k€ / year	Different type of investors	▪ not possible to invest in equity in the most important forms of social entities ▪ most projects invested in are very small (50k€ turnover) ▪ very few investors accept the type of risk associated with seed capital
Crowdfunding	8k€ (until now in 3 months)	Esolidar	▪ there are several explanations for it not being used: the most probable would be that most citizens that donate would be uncomfortable with the technological aspects (debatable)

Sources : desk research , Focus Groups output, and team analysis

6. Portuguese Market Analysis

The biggest hindrance at this stage to the existence of a Social Investment market is the state bodies attitudes and rules

- Whatever form of Social Enterprise cannot compete for government contracts
  - By definition, entities competing for government social bids cannot have profit purposes
  - Social bids are based on costs considerations – there are no qualitative considerations, i.e. the price paid does not depend on quality considerations and/or social outcomes
  - It is possible to spin-off parts of those activities – but then they are excluded from government funding.
- Even if a Social Enterprise could formally compete it would face an impossible proposition in terms of business case:
  - Due to the added cost of capital – i.e.: as social entities such as IPSSs do not have equity and most of their assets are "loaned" or rented from the State, they have a much lower "cost of capital" than a normal corporation.
  - In fact what is happening is that some social enterprises are creating spin-offs to sell commodities
- Administrative burden and lack of transparency
  - In terms of administrative burden, government contracts impose a big overhead in terms of reporting
  - Accessing government data is next to impossible

6. Portuguese Market Analysis

The future: the Portuguese government position on Social Business

> In his 2020 agenda, the Portuguese government recognizes the need to evolve the social sector framework. Namely, it points at the actual scarceness of financial tools to support the social sector and proposes to incentivize the use of financial tools from the business sector in social economy, such as
- Investment funds
- Business angels
- Crowd funding

> For this purpose the government proposes to create a Social Investment Fund as a mediator for social investment.

> The government's responsibilities will be:
- To establish specific criteria for social investments;
- To analyze and recommend to the appropriate investors to invest;
- To negotiate contractual agreements with social investors;
- To monitor and to produce progress reports;

> Overall acting as a support net for the management of the entities whose scope is the socially excluded

> Besides the financial side of the equation and the obvious need for incubators, the government recognizes the need of increasing business capacity building for those investing in the social area on matters like:
- Legal
- Economy
- Communication
- Marketing

> A concrete quantified explanation of how all of these intentions are supposed to be implemented and financed is not available at this time. However we see these declarations of intent as a good sign of the government's support for the creation of a healthy environment for the development of Social Enterprises

What this document does not address:

- legal issues
- government purchasing rules
- social security contract rules
- the existence of social enterprises
- the model for social impact evaluation
- how private investors should be attracted

Source: POISE – Programa Operacional da Inclusão Social e Emprego 19/02/2014 Portuguese Government

6. Portuguese Market Analysis

Different actors emphasize different issues

Banks	▪ Although there are available funds for SME, Banks do not have a social projects pipeline to invest in ▪ They do not have a vocation to target SEs, particularly in the context of the non existence of a legal frame for SE's in Portuguese Law ▪ The social sector as a whole is not treated differently from the rest of the economy as there is no incentive to do so. Even for (state-owned) banks, which target the social sector, it is still a marginal segment and with no specific credit evaluation criteria ▪ On the subject of micro-credit, it seems difficult to do better within the context of Bank of Portugal prudential rules, which lead to a 90% rejection rate and which entail a 2500 Euros minimum cost/approved credit which is clearly non economical
Other financiers (funds)	▪ Only one stated that it was seeking Impact Investment ▪ All refer the lack of projects pipeline ▪ Focus on the pre-pitch process and not social impact « true » evaluation ▪ None of them is looking for scaling up of the SE industry
Incubators /Business Angels	▪ Most venture capital and business angels focus on tourism, health and high tech ventures. ▪ Social projects are rare and are not their main object ▪ Amounts available are very small and all the focus is on the pre-pitch process ▪ Focused on seed capital – i.e.: unwilling to disburse more than 10k per deal
Corporations	▪ Top 100 corporations do make sizeable amounts of donations ▪ Very few treat them as a true investment, the focus is on brand communication ▪ Generally, focus is on the number of investments (say 1000 investments x 1000 Euros) rather than on social impact ▪ Impact is still confused with number of beneficiaries

Sources : Interviews and desk research – Focus Groups output, team analysis

6. Portuguese Market Analysis

Different actors emphasize different issues

Incubators

- **Business**: their business activities are mainly focused on the pre-launch stage of the SE
- **Social enterprise definition:** the majority agrees that a social enterprise should fulfill a social need and at the same time be financial sustainable
- **Capacitation**: the majority believes that social enterprises don't have a financial strategic thinking and business competences, although they should. They also think that most of the entrepreneurs try to solve a local problem and then don't know how to scale it and sometimes are not even interested in doing it.
- **Social Impact measurement**: Nothing is being done. Its importance is recognized, but the main concerns range from how to standardize it, so that is comparable, to the huge amount of resources spent in order to evaluate it
- **Social impact investing**. The majority don't think that there are investments in the growth phase of the SE, only in the first stage

SSIs

- **Business:** all have an increase in demand; some are trying to diversify their offer (for instance: different projects to offer to the corporations) and to be profitable – urge to do the same/better with less money
- **Social enterprise definition**: some of the SSIs recognize the importance for having profit as a means to have more social impact, others believe that they must be only sustainable and not profitable
- **Government support**: They refer the inability of the governmental institutions to go beyond the strict cost-based contract (benefits-sharing for example)
- All of them refer an excessive administrative burden of reporting to different government entities.
- **Capacitation:** agree that there's a lack of business capabilities, and a need for better resources in areas such as finance, communication and marketing
- **Competition**: the sector is too competitive (all compete with all) and they should cooperate instead. Moreover, they believe that the credibility of an institution is not only based on its internal management but depends on the institutions as a whole
- **Social impact measurement:** its importance is recognized but very little is being done. It would bring credibility to the institution. They refer it is good to understand what they are doing right/wrong and also to get more funding. They also believe that the Government should request to all institutions to measure social impact in order to understand who should receive funding; they would like standardized methods to be implemented
- **Social impact investing**: all of them understand that an investor should have a financial return on its investment

6. Portuguese Market Analysis

Different actors emphasize different issues

ONGs	▪ **Business**: ONGs feel they don't have critical mass and that the majority of ONGs don't think global ▪ **Social enterprise definition**: all of them believe that the goal must be the maximization of the social impact and not the profit, creating value to all stakeholders involved, by doing business with a purpose. They also think there should be a legal form that recognizes that the social enterprises can have profits ▪ **Capacitation**: all recognize that it is important for ONGS to have more support in order to be ready for investment and more support in communication, finance and strategy ▪ **Competition**: the majority feels that the sector is too competitive (all are vying for the same sources of funding) and they should cooperate instead ▪ **Social Impact measurement**: none measures SROI but are planning to as they believe it is important, specially to investors. They also raise the issue that many organizations measuring impact do not communicate it well. They would like to have a standardized report process to evaluate SROI
Social entrepreneurs	• **Social enterprise definition:** there is a consensus that a social enterprise should generate revenues, have a social purpose and re-invest partially its profits in its activities. There is no consensus on how much can be distributed to shareholders. • **Social impact measurement**: some are already measuring it as some investor request it, but most of them feel that is difficult to measure it and need support • **Social impact investing**: some agree that investors should have a financial return on investment but others strongly disagree • **Difficulties**: business capacitation, legal form of a social enterprise, long-term financing and how to scale

7. Conclusions

7. Conclusions

Getting practical – a case study

> Beyond the point-by-point analysis lets do a practical case of what would happen if a social entity decided to act as a Social Enterprise and a) expand or b) bid for a social government contract

- By definition to have access to fiscal deductions and social government contracts it would need to be incorporated as an IPSS or CSS
  - that would preclude it from both having equity, and having a formal positive financial objective (beyond the Social Impact criteria) and raising debt.
  - also, in most cases, it would have no collateral to speak of (there are no asset lock provisions in the Portuguese law)
- In the case of expand it would need financing – from whom?
  - from the traditional banking sector
    - » that financing would not be easily forthcoming as there would be no collateral and no equity
    - » whatever the case, financing would not be enough for more than day-to-day treasury
  - finding an outside investor is almost precluded in the sense that whatever financing would have to take the form of a bilateral loan arrangement (thereby precluding equity valuation options)
    - » in terms of governance, the investor would have no say in the running/governance of the entity
    - » last, there are no outside investors ready to invest more than 10k€ per deal (with the exception of one foundation – which is not mainstream)
- In the case of qualifying for a social government contract
  - it would have no incentive to go Innovative as there is no bonus for a qualitative and/or innovative approach. And anyway, building a business case based on institutional data is next to impossible (not accessible)

> We are assuming of course, that the said entity has an executive team with the needed management skills to formalize such a need and a Board with the open-mindedness to look favorably upon to such a venture

• As a conclusion, we can say that there are multiple blocking points that prevent the transformation of a social entity into a Social Enterprise. And those blocking go much beyond the existence or not of money.

7. Conclusions

There is a strong disconnect between what is needed and the market readiness status

What is needed

- A clear government position
- Incentives (carrot/stick)
- Legal framework
- Available funding

The state of readiness of the different actors

- The social sector as a whole: **Unready**
- Corporations: **Uninterested**
- Trusts: **Unwilling**
- Banks: **Uninterested**
- Government Institutions as funders: **Not moving**

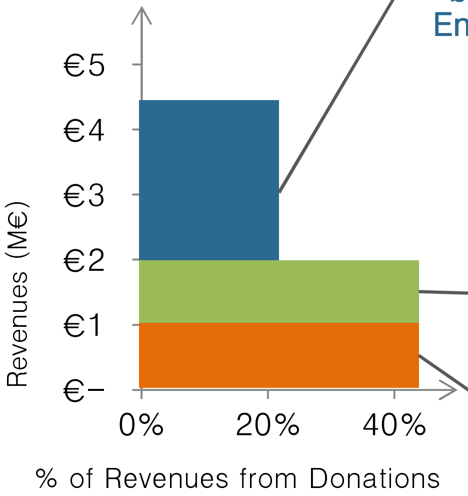
"And they all have different expectations"

- **Taking into account the state of the market, we believe that the market will not move as long as the issues which depend on the state "attitude" are not cleared and show a will to break with the "old funding model"**

Two issues need to be cleared: this is the team perception of the state of the market, based on all the individual talks – the advantage we have is that we have sounded stakeholders from the different quarters. The second, an advantage, is that having done the benchmark we think we have built a good perception of what are the « minimal starting conditions ».
A third issue has to do with the public debate/knowledge issue: though the government has been releasing some « sound bytes » in the last 6 months – which we believe point in the right direction – as the negotiations continue, nothing is yet clear in terms of what are the major changes to be effected.

7. Conclusions

What exists and what could be: the different segments suffer from specific issues



	Demand issues	Supply issues
Our Target: largest social organizations with a potential to become Social Enterprises (SEs)	▪ Legal blockage ▪ Lack of business capacity ▪ Dependence on donations	▪ Non existence of enough funding options ▪ Lack of support from market intermediaries ▪ Limited Civil Society support ▪ Corporate world funding non-core social issues
Potential	▪ The same issues above ▪ Even more dependent on donations	▪ Investing in unsustainable balance sheets
Seed Capital	▪ Too few and too small ▪ Most based on non-scalable ideas ▪ Grounded on local support ▪ Lack of will to scale-up	▪ No dedicated seed capital focus ▪ Support focused only on pitch stage

Source: Interviews with investment fund managers in the UK and FR

7. Conclusions

What we've learned

> Looking at the Social Enterprise investment market

- Portugal is not where the UK and France were in 2006:
  - The market as a whole is no where near as aware for the need or the concepts
  - The demand side still lacks the drive to go for scale and the trade-offs inherent to that choice
    - At the bottom end of the scale, most initiatives sprouting up lack the tools to flourish
- we talk the talk but we don't walk the walk
  - Though nominally most items of what would be the infrastructure of a social investment market do exist, they simply don't work
  - Doing something still needs to break many barriers to get from the ground up
- Looking at UK and France, they are very different from what they were in 2006
  - The recipe was different but they are at the same point essentially
    - Which means that there are no pre-mandated rules
    - BUT we should recognize that some ingredients are more important than others
    - AND in fact there it boils down to some simple things that need to be made to work

(*) we assume that for all generic affirmations, there are always better and worse exceptions to the rule

7. Conclusions

What we've learned

> **As a conclusion, there is no doubt that the market of Social Enterprises does not exist today** (*)

- The stocks and flows are almost non existent

– Demand does not seem to be aware of the need to change – and even less of the possibility to change:
  - – Additionally it suffers from a systematical lack of critical mass (fragmentation)
  - – Some that have critical mass are resistant to change
  - – They are hindered by a number of rules and laws that block the evolution of the market

- Supply does not exist formally – as in targeted for the purpose

- The intermediary market is fragmented

- The way the government machine works is possibly the biggest brake to change, namely in:
  - – Non recognition of social impact cost gains in bidding and payment of services
  - – Bidding process made on the basis of costs
  - – Lack of transparency from the smallest details up

- And the legal framework is unsuited for the purpose
  (on the basis of the comparison with other countries)

> **This could be seen as a huge opportunity, if we dare to learn with the best students**

(*) we assume that for all generic affirmations, there are always better and worse exceptions to the rule

8. Recommendations

8.1 Recommendations

The challenge to create a market for SEs is basically the same as the challenge to fund the social market as a whole – i.e. to solve the following:

- To create/develop institutions with critical mass
- To transform a donation-based market into an investment-friendly market.

It is our belief that as a pre-condition for the implementation of a successful Social Investment Market in Portugal, it is fundamental to have a market structure based on the UK model, as follows:

What's NEW:

Central pool of funding (Big Society) → € → **SIFI (e.g.: Social Finance)** → € → **Social Entities (SSIs)**

Central pool of funding (Big Society):

- Manages a central pool of funds
- Only invests in Social Impact projects/entities
- Has different objectives AND risk thresholds
- Develops/developing the market IMPLIES having funds intermediaries (SIFI´s and not only)
- Has expertise both in financial and social issues)
- Allows for time to create operational efficiency

SIFI (e.g.: Social Finance):

- Creates, manages and markets financial products
- Does investment leg work: due diligence, among others
- Ensures relationships with investors and social sector
- Looks for better ways to define Social Impact and manage projects

8.1 Recommendations

Topic	What	Comments	Country
Funding – creation of a liquid market	Create 1 pool of funds (like Big Society Capital)	▪ The copy of the UK concept, namely through using as a source of funds a mix of unclaimed assets and public/EU funds ▪ In terms of execution do a task force to go bank by bank (though it will face some resistance) ▪ Focus on priority sectors	UK+FR
	Create a similar concept of the French « Solidarity Pension Fund »	▪ As a complement to public banks, allow civil society to finance the emergence of SEs ▪ We do not see any issue with a complete copy of the French law/modus operandi (though confidence in the financial system is at an all –state low)	UK+FR
	Focus on 2 operating funds (SIFIs)	▪ Portugal does not have the size to support many funds – so as to protect and push for efficiency – Ideally there should be 2—The role of the state should be to be a minority investor and define the rules	N/A
	New products (to be detailed in latter pages)	▪ Lower interest rates loans, and longer maturities ▪ Different risk thresholds/profiles accepted ▪ Centralize funding of this process type in one bank/financial agency ▪ Monitor efficiency (i.e.. focus on efficiency and practical impact) ▪ Products for collateral protection /state guarantees ▪ Products targeted for intermediary funding ▪ Test SIBs (based on traditional English model or on simpler bilateral agreements)	UK+FR
	Creation of an intermediary segment	▪ Allow intermediaries to access public funds – allow x% of funding to be allocated to intermediaries – mandate for specific works to be done as a standard (e.g.: mandatory social impact evaluation) prior to funding	UK+FR
	Investing on capacity building	▪ Social reality and social knowledge for investors ▪ Common language to reduce gap between supply and demand	

8.1 Recommendations

Topic	What	Comments	Country
Law	Change the law on the social sector to allow for SEs definition	▪ Include the for-profit concept for social enterprises and, ideally, also the other legal concepts related to SEs of the French or UK legal frameworks (which are essentially the same)	UK+FR
Government	Change the bidding and contract evaluation process	▪ The government is the biggest client of this type of companies. As such it should change the contracts to reflect the weight of Social Impact , both for efficiency, and outcomes, namely: ▪ In the bidding process stop SSI from being the sole beneficiary of the Social Security Bids ▪ Include impact evaluation as an additional criteria for winning a contract (beyond the strict cost/price approach) / and/ or give bonuses for companies that include a social impact ▪ Include a shared bonus scheme for social performance delivery / and / or costs savings for the state/society in the calculation of the payment model	UK+FR
	Embed social impact in the day requirements of the government institutions	▪ Social impact evaluation should be mandatory for non curative and palliative types of services, in all areas of social intervention	UK
	Define priority concerns for funding	▪ Some social issues (typically those that have a low media attractiveness rating) have a high social priority and have been cash starved for lack of funding – target them for alternative methodologies of social innovation, product/funding mixes and impact evaluation methodologies (examples: testing on young unemployment (the London example), and adapt different SIB – like approaches (to be detailed) ▪ Communicate progress	UK
Management	Create a supervision management authority to manage the process	▪ The UK government has shown that a well piloted process can be executed fast ▪ Too many pieces depend on different government ministries not to be tied together by a central authority, both for priority setting, supervision, and correction.	UK

8.1 Recommendations

Topic	What	Comments	Country
Government	Data transparency	▪ As in the UK allow for open data standards in particular focused on publication of standard government cost basis information for all type of public services	UK
	Communicate progress often and widely in a fact based transparent way	▪ In order to attract talent and accelerate change	UK
	Organize (and give easy access to) a useful pool of data, from the simple publication of accounts to best practice sharing	▪ To increase entrepreneurs' chances of success by providing adequate management tools , helping them to avoid known mistakes	UK
	Define a doctrine	▪ Pushing for social actors to achieve critical mass needs consistency in the measures to be pushed – define the signs that will give bonuses and those that will give maluses. Define what is understood by social impact and outcomes management.. The issue of natural selection should be tackled in a more straightforward manner – namely to promote a more heads-on approach.	UK+FR

8.1 Recommendations

Topic	What	Comments	Country
	Capacity building	▪ A lot is being done on building business capacity by private foundations. It clearly needs to be intensified and focused mainly on management skills	UK+FR
	Push for critical mass	▪ The push for critical mass is the sum of a lot of the measures detailed above.	UK+FR
	Define social impact standards/ operating measures	▪ Standardized basic social impact measurement metrics, need to be made operational by the government	UK
Demand	Give access of biggest to development funding	▪ The separation of development capital and seed capital is paramount as they require different risk thresholds and operational skills	UK+FR
	Give access of smallest to seed capital funding		UK+FR
	Help development process	▪ What is intended by this measure is the following: due to the first 2 years lack of experience and invested funds, most funds are/will be very inefficient from an operational standpoint. That should be taken into account in the funding process. (typically, in France and the UK, intermediaries receive grants to help them survive this period).	UK+FR

8.2 Recommendations – Recommended new products

Products that could be developed	Who/ scope	Issues
More « flexible loans » –Extension of maturities – lower interest rates	From banks/ foundations/ equivalent of SIFI's	▪ Its debatable whether that would change a lot in the context of the unsustainable economics of the social sector ▪ EBITDA´s of most social entities would not be changed by a lot ▪ the issue of high risk, lack of collaterals and difficult collections has to be solved first
Collateral guarantees	Central financial entity for social sector (something akin to Big Society) Not a normal bank	▪ Could be a very relevant product, in the sense that it would lower the risk perception ▪ Needs to be given by a dedicated institution to the development of the social sector
SIBS type 1 (the traditional)	Need some fund to emerge in Portugal with financial and social capabilities Need the existence of some kind of pooling mechanism (akin to Big Lottery)	▪ Complex for the short term ▪ There are no private investors interested in the type of issues tackled by SIBs in the rest of the world (with the exception of youth unemployment-related issues) ▪ Government has to admit beforehand the issue of Social impact as a metric objective and the issue of sharing benefits with investors. ▪ It is highly doubtful that a private investor would take the lead in this process, taking into account the amounts involved and the difficult relationships between government institutions and private investors

8.2 Recommendations – Recommended new products

Products that could be developed	Who/ scope	Issues
SIBs type 2 (hybrid): Based on bilateral agreement between an investor and a social entity where « the repayment would be indexed and inversely proportional to the social performance of the project »	Has to be developed by some kind of funding house (a SIFI) in articulation with investors	▪ Would solve partially the issue of complexity and the need to depend on the state ▪ Would not solve the issue of need to find a pool of investors to fund one project ▪ and the list of social priorities might not be to the taste of private investors ▪ One of the benefits is that it is legal and enforceable immediately
Funding lines	For SIFI´s / from central entity for funding	▪ Today existing SIFI´s, do not have access to any kind of funding lines ▪ As such they are cash-starved and so their investments are very limited in scope and ambition ▪ There would be interest for a central funding facility to be drawn down (as an example, that's a big part of the Big Society 26M€ commitments)
Specific equity/grants	For intermediaries From Central entity	▪ To grow the market, some entities cannot be profitable. In that context they have to be funded – at a loss – so that the market can grow (that is one of the big learning points from the UK – France is having trouble with that)
Solidarity/social pension funds and /or insurance (i.e..: the « French scheme »)	– For private citizens – Managed by the state –To fund SIFI´s	▪ That would allow to transform donations into investments ▪ Oblige investors to have more financial discipline ▪ Pool the contributions of civil society ▪ Allow for creation of critical mass of some SIFI´s ▪ Potentially the most impactful product ▪ But politically very sensitive

9. References

9.1 References

9.2 Recommendations – Persons Interviewed

9.3 References – Stakeholders: focus groups

9.1 References

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9.2 References – Persons Interviewed

Name of the person interviewed	Role and Organization
Jean Luc Perron	CEO – Fondation Credit Agricole – Grameen
JM Lecuyer	CEO – CDI (ex-CEO Sipar)
Louise Swistek	CIO – CDI
Anne Sophie Do	Program Director – CDI
Carole Bazina	CEO – Danone Comunities
Nadyal Sattar	Social Investment manager – Big Society Capital
Travis Hollingsworth	Director – Big Society Capital
Charu Wilkinson	Project manager – GHK
Benedicte Faivre-Tavignaud	Head of HEC business school – Chair of sustainable development

9.3 References – Stakeholders: focus groups

Name of the person interviewed	Stakeholders Category
Manuel Paisana	Banco Alimentar
Teresa Ricou	Chapitô
Rui Martins	Dianova
Cristina Louro	Cruz Vermelha
Ana Alves	Ajuda de Mãe
Sónia Pereira da Silva	Santa Casa da Misericórdia de Lisboa
Mário Caldeira Dias	Caritas
Ivone Félix	Cercioeiras
Alexandra Mendes	Cercioeiras
Nuno Arez	Biovilla
Frederico Fezas Vital	Terra dos sonhos
Henrique Sim-Sim	Fundação Eugénio de Almeida
Isabel Pinheiro	AMI
Isabelle Romão	AMI
Karren Ferrez Frisch	Fundação Manuel Violante
Madalena da Cunha	Call to Action
Cláudia Pedra	Stone Soup Consulting
Rogério Roque Amaro	ISCTE
Cláudia Oliveira	Chapitô

*not to be confused with CDI France

9.3 References – Stakeholders: focus groups

Name of the person interviewed	Stakeholders Category
Madalena Cotta	Reklusa
Mafalda Lima Raposo	Reklusa
Diogo Silva	Transformers
João Baracho	CDI Portugal*
Katia Almeida	Eslider
Suzanne Rodrigues	Projecto Marias
Frederico Cruzeiro Costa	Agência de Empreendedores Sociais – SEA
Francisco Pessoa	BIS – Santa Casa Misericórdia
Luís Matos Martins	Audax (ISCTE)
Marta Andrada	Dna Cascais
Raquel Santiago	Pressley Ridge
Filipe Portela	Fundação Mais

*not to be confused with CDI France

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