Concerns and main barriers for financial intermediaries on the access to instruments funded by the EFSI and more in general on the financing of social service providers

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Abstract:

This document investigates two main areas of interest for financial intermediaries: the first regards the European Fund for Strategic Investments and its main barriers to adoption for the intermediaries; the second assesses the concerns intermediaries have when providing credit to social service providers. To this end we used two methods of analysis. We conducted a survey among financial intermediaries themselves who have used or plan to use EFSI instruments in order to get a first-hand understanding of the issue. Additionally, we have also reviewed some literature on how credit institutions assess the risk of funding the social economy and social service providers in particular.

1. Introduction

This paper describes the concerns and main barriers for financial intermediaries on the access to instruments funded by the European Fund for Strategic Investments (EFSI) and more in general on the financing of social service providers.

We start our exposition with a general overview of what the EFSI, the social economy and social service providers are. Afterwards, we analyse the main barriers financial intermediaries find when they try to get EFSI funds. In this case, the methodology used to collect the feedback comprises both an online questionnaire and phone interviews.

In the following section, we tackle the second main area of interest of the paper, the barriers social service providers and the social economy in general face when looking for financing opportunities. What emerges from our research is that there is a certain lack of awareness regarding both the EFSI and social service providers on the intermediary's side, however the potential for synergies is present: financial intermediaries can access EFSI funds in order to lower the risk and "discover" the opportunities social service providers offer.

2. The European Fund for Strategic Investments

Since the global economic and financial crisis, the EU has been suffering from low levels of investment. Collective and coordinated efforts at European level are needed to reverse this downward trend and put Europe firmly on the path of economic recovery.

The EFSI is an initiative launched jointly by the European Investment Bank (EIB) Group and the European Commission (EC) to help overcome the current investment gap in the EU by mobilising private financing for strategic investments. The EFSI is a € 16 billion guarantee from the EU budget, complemented by an allocation of € 5 billion of EIB's own capital. Its dedicated governance ensures that it remains focused on its specific objectives, namely to increase the volume of higher risk projects supported by EIB Group financing operations and address the market failure in risk-taking which hinders investment in Europe[1]. However, it is important to stress that the EFSI is not a Fund or other legal entity nor does it trade independently[2]. Moreover, we have to keep in mind that the EFSI entered into its operative phase in 2015 and therefore it is in its first steps: further instruments and tools are still being developed and might become available throughout 2016 and 2017[3]. According to the EU Regulation on the European Fund for Strategic Investments[4], the social economy is one of the core areas of intervention.

As of January 2016, two paths for accessing EFSI funds are available: through the EIB and the European Investment Fund (EIF). Before going into detail, it is important to underline the fact that at the moment EFSI funds will actually be used to strengthen financial instruments that are already existing: most of such instruments are deployed via local financial intermediaries (banks, investment funds, microcredit institutions, etc.), and are not specifically targeting social service providers. The criteria used to select the projects to be funded comprise high societal and economic value contributing to EU policy objectives and projects must attract private capital by addressing market failures[5].

The existing facilities managed by the **EIF** that will take advantage of the EFSI funds are the following (note: it is likely that further products will be designed)[6]:

- COSME Loan Guarantee Facility[7]: Capped Guarantee for Riskier SMEs. It will support lending to higher-risk SMEs without a specific sector or stage focus;
- InnovFin SME Guarantee Facility[8]: Uncapped Guarantee for RDI-intensive SMEs and Small Mid-caps. It will support lending to research and innovation intensive SMEs and small midcaps that cannot realise their investment projects in full with traditional senior secured loans. The guarantee will cover the part of the cost of investment projects that is not supported by traditional lending;

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1 http://www.eib.org/about/invest-eu/index.htm?lang=en
2 http://www.eib.org/attachments/press/investment_plan_for_europe_qa_en.pdf
3 https://eu-access-to-finance-day.teamwork.fr/docs/luxembourg/presentations/Roger-Havenith.pdf
4 http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2015.169.01.0001.01.ENG
5 http://ec.europa.eu/priorities/jobs-growth-investment/plan/efsi/index_en.htm
6 https://eu-access-to-finance-day.teamwork.fr/docs/luxembourg/presentations/Roger-Havenith.pdf
7 http://www.eif.org/what_we_do/guarantees/single_eu_debt_instrument/cosme-loan-facility-growth/index.htm
8 http://www.eif.org/what_we_do/guarantees/single_eu_debt_instrument/innovfin-guarantee-facility/index.htm

- Equity[9] facility for the early and growth stages, including co-investment. It will focus on providing equity financing to SMEs in their seed, start-up and early stages as well as growth and expansion stages. It will also offer a co-investment facility to equity funds and serve as a possible basis for closer cooperation with National Promotional Operators.

In the case of the **EIB**, the application procedure is divided into two categories depending on the amount that is being requested and the watershed is whether a project requires more or less than € 25 million. Project promoters can directly get in touch with the EIB only for projects that are above the € 25 million threshold. Otherwise, they need to contact financial intermediaries that are financed by the EIB[10].

It is important to note that at the moment the EU instruments supported by EFSI are not explicitly targeting social service providers, but can still be used by financial intermediaries for such kind of beneficiaries, as long as they meet the requirements set by the EIB and EIF. In addition, there are two European financial tools that specifically target social entrepreneurship (**but** are not enhanced by the EFSI at the moment) and are again deployed via financial intermediaries. They are therefore really interesting for financial intermediaries focusing on or willing to explore such sector:

- the **European Commission**'s Programme for Employment and Social Innovation[11] (EaSI) has issued a dedicated Guarantee facility, a financing instrument at EU level to promote a high level of quality and sustainable employment, guaranteeing adequate and decent social protection, combating social exclusion and poverty and improving working conditions; and
- the **EIF**'s Social Impact Accelerator[12] (SIA), the first pan-European public-private partnership addressing the growing need for availability of equity finance to support social enterprises.

	EIF	**EIB**	**European Commission**
EFSI	• COSME • InnovFin • Equity	• EIB loan • Intermediated loan	

[9] http://www.eif.org/what_we_do/equity/index.htm
[10] http://www.eib.org/projects/cycle/applying_loan/index.htm
[11] http://ec.europa.eu/social/main.jsp?catId=1081
[12] http://www.eif.org/what_we_do/equity/sia/

NON-EFSI	• SIA		• EaSI

3. Social Service Providers

Regarding the concept of social service providers, in 2006 the European Commission described in a Communication[13] what constitute Social Services of General Interest (SSGI) and we use this definition to encapsulate social service providers. It identified two broad types of services, namely:

- statutory and complementary social security schemes covering the main risks of life; and
- services provided directly to the person, such as social assistance services, employment and training services, childcare, social housing or long-term care for the elderly and for people with disabilities.

In 2007[14], the Commission refined its analysis of SSGI and highlighted a certain number of objectives that social services pursue — such as responding to vital human needs, contributing to non-discrimination and creating equal opportunities. The Commission also highlighted the principles of organisation which are common to these services — such as solidarity, proximity, comprehensiveness, personalisation and an asymmetric relationship between user and provider.

Both documents show that social services play a prevention and social cohesion role in European societies. They not only help people to live in dignity and enjoy their fundamental rights, but also to fulfil their potential and to take part in society[15]. Social service providers share certain characteristics with the social economy that can be used by the former to benefit from initiatives and instruments that are designed for the latter, provided that they meet the eligibility criteria.

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[13] *Implementing the Community Lisbon programme: Social services of general interest in the European Union*, COM(2006) 177 of 26 April 2006.
[14] *Services of general interest, including social services of general interest: a new European commitment*, COM(2007) 725 final of 20 November 2007.
[15] *Towards Social Investment for Growth and Cohesion – including implementing the European Social Fund 2014-2020*. 3rd Biennal Report on Social Services of General Interest. European Commission 20/02/2013.

4. Barriers to Access EFSI Funds and on Financing Social Services

As previously said, the EFSI aims at supporting also social service providers. Despite the fact that there are no dedicated financial tools targeting such sector yet, further products will be designed, and hopefully some of them will therefore benefit them.

Some inputs might therefore be helpful at this point to improve the design of appropriate financial tools. On the one hand, it is important to analyse what the present barriers to access EFSI funds are, in order to avoid them in the future. On the other hand, it is also useful to understand what the barriers on the financing of social service providers are, in order to deploy tools that really tackle the needs of the sector.

To this end, we conducted a survey between November and December with the objective of gathering as much feedback as possible from financial intermediaries, in order to better understand the situation from their perspective. We took into account two main groups. The first took advantage of the expertise provided by the FEBEA network[16] in the field of providing funding to the social economy; the second featured a selection of financial intermediaries that already benefit from EFSI funds. The number of intermediaries that was contacted is thirty-three and we received feedback from ten of them (for more information, please check Annex I). Due to budget and time constraints, it was not possible to include a larger number of intermediaries. The gathering of the feedback took the form of phone interviews and online questionnaires (for the full version of the questionnaire, please check Annex II).

Focusing on the barriers to access EFSI funds, it is possible to split the feedback into two groups: general and instrument-specific.

In the first group, many intermediaries lamented a lack of information and a difficulty in getting what is available. The instruments are not publicised enough and the information is not very clear.

[16] FEBEA is the European federation for ethical banking and has the objective of developing ethical and solidarity-based finance in Europe through the dissemination of information and citizens' participation. For more information, visit: http://www.febea.org/

Others pointed out that there are too many passages in the disbursement of funds - from the EFSI to the EIB/EIF to the instrument. Given the strict definitions that are in place and the eligibility criteria it is difficult to expand the use of the instruments to a wider range of social service providers.

As for the second group, some organisations knew/used only one instrument, hence they provided feedback specific to their expertise. For the COSME Loan Guarantee Facility financial intermediaries reported that while it is useful, it is difficult to meet the required deadlines, and the economic conditions found in the Call for expression of interest are too restrictive. Furthermore, the procedures are too complex and unclear, while filling the application documents requires too many internal resources. One respondent also lamented a linguistic barrier when applying for it. For the InnovFin SME Guarantee Facility the main point that was highlighted was the instrument's misalignment with the intermediary's financing needs. For EaSI, respondents lamented that the technical and economic conditions of the instrument are too restrictive. Finally, the Equity instrument requires certain specific characteristics that not every financial intermediary possesses and may be too expensive to acquire.

Regarding the information above, it should be noted that these instruments have been established quite recently and some time is needed to adapt to the new instruments and effectively develop the necessary internal procedures that satisfy EU criteria. Hence, it is likely that several procedural issues will be solved as the instruments are used.

Moving on to the barriers on financing of social service providers, in addition to the questionnaire we can also take into consideration the expertise gathered on such topic by FEBEA, whose members are indeed specifically focused on financing the social economy and social service providers.

As previously said, social service providers and social enterprises in general have been identified as a strategic and resilient sector, able to satisfy not only economic needs and long-term employment but also provide positive externalities to the wider society. However, they also face a number of challenges, especially regarding access to finance. The Commission itself considers that the funding system for social enterprises and social service providers is underdeveloped in relation to that used by other businesses.

Indeed, their funding needs vary according to their level of development (conceptual support, development of pilot projects or prototypes, large-scale development) but more so than other businesses, social service providers are confronted with the imperfections in the financial markets (fragmentation, absence of pan-European platforms for lending, etc.) and they are considered as presenting a higher risk than "traditional" enterprises. The reason for this is twofold.

Even though there are social service providers that have budgets in the order of billions of euros, there are numerous service providers who are much small in size. Hence, this diversity must be recognised. From a business/market point of view, the smaller social service providers often find it harder to provide sound business planning often due to a **lack of expertise and human resources necessary for drafting sound financial projections** that many financial intermediaries require. Finally, due to their size, often their **need for financial support is quite limited**, which means that financial intermediaries would incur into **high costs (due diligence, internal procedures…)** compared to the size of the funding provided. This, in addition to the **relative low number** of social enterprises within a country and the **wide spectrum of fields** where they operate (manufacturing, social services, tourism, etc.), creates high barriers for investors.

From the point of view of the awareness, many **financial intermediaries lack some basic information** about social service providers, such as the kind of market, the business model and how to measure the social impact of the sector. Due to different national definitions of what a social service provider is, financial intermediaries can find the sector as a whole **difficult to analyse and measure** in a systematic way, and general features such as constraints concerning redistribution of profits or employment of vulnerable workers often give the impression to creditors or potential investors that they are higher-risk and less profitable than other businesses. This **asymmetry of information** obviously increases the risk perception.

In addition to this, even if we see indeed an increasing numbers of investors seeking to combine social or environmental results with their legitimate concern of obtaining a financial return on the investment[17], the **measurement of the social impact** of **a social service provider** (which should be the main attractive feature of such sector) **is not as straightforward** either. Firstly, there is **no unique way of measuring the impact**. While there are some well-known social impact measurement systems, such as IRIS[18], this lack of standardisation means that it is difficult to compare enterprises that use different benchmarks. Secondly, related to their small size, many social service providers **lack the resources to gather consistent and comprehensive information** about their social impact, making such an assessment difficult.

Generally speaking, often investors see a **lack of competences** in social service providers concerning management, business planning, impact measurement, etc. This indeed may be related also to their **lack of education on social entrepreneurship and social service provision issues**. While classes on economics are included in curricula from grade school to business schools, formal education and

[17] http://ec.europa.eu/internal_market/social_business/docs/COM2011_682_en.pdf
[18] https://iris.thegiin.org/

training on social entrepreneurship and the social economy is still largely absent from the classrooms. This obviously means that it is much more difficult for social service providers to find staff and managers with the necessary mindsets, skills and competences than it is for conventional businesses[19].

5. Conclusion

What emerged from our analysis is that several financial intermediaries are still in the process of fully understanding what the EFSI is and how they can access the funds. The procedures are not fully understood and implemented, which in turn creates misunderstanding and, for some, reluctance to use the new instruments. Some have expressed frustration at some of the parameters, considered too strict.

Despite this, many intermediaries clearly show interest in the funds and are willing to examine in more depth what is available. Furthermore, the simple fact that a financial intermediary collaborates with European institutions is seen as an improvement in its reputation and more generally in its strategic positioning, which takes into account the possible developments of the European financial sector in the future. For the intermediaries that already benefited from EFSI funding, they were satisfied with the economic advantage they got.

Regarding social economy and social service providers, many respondents were keen on accessing this market. However, social service providers represent only one sliver of their potential customer base and they seemed more concerned by the providers' creditworthiness than by the social impact. Another issue that negatively affects social service providers' access to credit is a lack of awareness of their wider positive impact and - perhaps more important - of their economic resiliency and ability to tackle the new challenges that the economic crisis has highlighted.

Propitiously, the EC has stressed the importance of the social economy as a key sector for Europe's sustainable growth and is willing to deploy more tools to boost its growth. This way financial intermediaries may become more willing to focus their lending to social service providers, for they

[19] http://ec.europa.eu/social/main.jsp?catId=738&langId=en&pubId=7523&type=2&furtherPubs=yes

tend to present a solid investment opportunity not just by themselves, but also in the larger society. It is no coincidence that more and more economic agents have been recognising their resilience and potential.