

How to design an appropriate financial framework for social entrepreneurship in the European Union?

18.11.2011 Address to the Conference “Promoting social entrepreneurship in Europe,” Boris Marte, ERSTE Foundation

1. Introductory Remarks

Good morning, Ladies and Gentlemen! I'm Boris Marte of the ERSTE Foundation. I'm here today representing both the ERSTE Foundation and the Erste Group. Thank you for the invitation to be part of the Commission's dialogue on Social Business. A few words on why this topic is so important to us: the ERSTE Foundation is – as a civil society organization serving the public good – in a **rather unique position** to be the largest shareholder of the Erste Group. The Erste Group – if you are not aware – is by some measures the **largest financial services provider** in Central and Eastern Europe. The Group's roots go back to the early part of the 19th century when a Viennese priest together with a number of other *citoyen* purposefully decided to create a bank for the *supposedly* unbankable. They opened their doors to trades- and craftsmen at a time when banking services were exclusively a reserve for the wealthy. The Erste Group was effectively established as a social business and that is why – unlike many other banks who treat microfinance and social enterprise finance as part of their CSR & PR efforts – it is **core to who we are**. It isn't a side-dish – it's the main course!

With respect to the Social Business Initiative, the ERSTE Foundation, good.bee and the remainder of the Erste Group would like to **thank the Commission** for developing an action plan that moves beyond simply creating enthusiasm for social entrepreneurship. We are very pleased that the Commission is taking concrete steps to ensure that vehicles are put in place that provide avenues for public and private investors to put their capital to work to support the development of this budding sector. Furthermore, based on the tone and the direction of the public consultation launched by the Commission concerning the promotion of Social Investment Funds, we would also like to **express our confidence** that the framework eventually established for private and public funds to flow into the sector will *indeed* match the needs of social enterprises. As all parties in the room certainly know, for our common efforts to support the development of social entrepreneurship to be effective, it is *imperative* that this be the case.

2. Financial Framework Considerations

Based on the experience we have gained in the last years in trying various methods to support Social Enterprises in Central and Eastern Europe, we'd like to point out some of

the insights we have gained into the needs and interests on both the supply and demand side of the equation.

First, as the vast bulk of Social Enterprises in our region – and we'd venture to say throughout the EU – are in their seed and start-up phase, it has become increasingly evident that forms of capital beyond traditional commercial loans are necessary. We estimate that – even using the most open-minded and flexible minds in the commercial banking sector – only 1 in 10 social enterprises has any debt bearing capacity at this particular point in the development of the sector. For that reason, we wholeheartedly agree with what many experts have already said. *Namely* that **it is critical** that vehicles and channels be established to deploy **patient capital** to social enterprises. This is particularly true for new social enterprises which offer innovative solutions to social problems. To be very specific, we must offer **grant, equity as well as debt** to social enterprises. The importance of **capacity building** – as the Commission rightly acknowledges – must also not be underestimated. **Grants** we consider particularly useful to support entrepreneurs as they flesh out their ideas and start to gain the knowledge and skills they need to successfully run their businesses. **Equity** – because only the most traditional of businesses starts generating cashflow from operations from day 1. In the most recent communication from the Commission concerning the Social Business Initiative, we observed the reference to social enterprises in their start-up phase requiring access to credit: we **strongly urge** all the stakeholders to be very cautious about the use of credit for start-ups. In our experience, unless structured with *very flexible* repayment terms, it is seldom the best instrument for start-ups, particularly innovative ones.

Second, the ERSTE Foundation welcomes the support of the European Commission in undertaking Key Action Number 9, specifically, proposing regulation for a European foundation statute. Based on our own difficult experience in providing grants across national borders, we welcome any framework that simplifies taxation for charitable grant giving throughout Europe. Additionally, we would strongly welcome the Commission's support in modifying the legal restrictions to charitable Foundations' ability to provide grants to *various* forms of social enterprises, *including* but not necessarily limited to limited liability companies.

Third, good.bee and the ERSTE Foundation would like to lend our voices to that group of stakeholders which feels that it is necessary to develop a new regulatory framework for social investment funds which are able to attract retail investors. As the Commission has

observed, persons across virtually all socioeconomic demographic segments are expressing a growing desire to direct the income they use for consumption and investment toward socially responsible and sustainable businesses. **Even more than that**, they want to **actively support** the creation of sustainable solutions to the social problems afflicting their communities. We therefore strongly advocate allowing retail – and not exclusively high net-worth – funds to flow into the sector. We do not think, however, that UCITS provides an appropriate framework.

Finally, we greet the planned mobilisation of EU funds which should act as a lever to the mobilisation of national public funds as well as private funds as a very positive step. It has become enormously evident that our previous efforts to create sustainable solutions to social problems while staying within the narrow perimeters of our roles and competencies as public sector, private sector and civil society actors have not been sufficient. Now more than ever, it is time for us to put aside our traditional hostilities and work together for the sake of our communities. Now more than ever, we need **unconventional collaboration** between all these sectors and we **welcome the Commission's efforts** to facilitate this. We **welcome Key Action Point Number 3** – and also strongly urge the Commission to ensure that the financial resources it deploys to support Social Enterprises be available not just in seeding or co-investing in funds, but also in the form of guarantees, the purchase of first-loss risk as *well* as to finance capacity building in the form of **grants** to social enterprises. Bearing pioneer risk will go a long way toward enabling Social Enterprises to create positive track records that will enable them to attract commercial funds. The **financing of capacity building** will furthermore – in the absence of hard collateral – go a long way toward mitigating the risk that might keep commercial lenders away from the sector.

When establishing the (1) pricing, (2) methods for applying for, and (3) the eligibility criteria for accessing public funds, we would admonish the Commission as well as national governments to (1) make them affordable, (2) not to establish unduly complex application processes nor (3) to establish unduly restrictive eligibility criteria. We are talking about funding **innovation**. If we are honest with ourselves (...particularly as bankers and politicians), we have to admit that we do not have full clarity on what tomorrow's solutions to our social problems will look like. For that reason, we **MUST** leave room for innovation and curb our natural inclination to be prescriptive.

With respect to eligibility, good.bee and the ERSTE Foundation would also like to express our strong wish that the Commission continue to lead a dialogue around that part

of its current definition of Social Enterprise which restricts their ability to issue dividends. At a minimum, greater clarity needs to be offered on what qualifies as “reinvestment “of profit. [In particular, we would seek confirmation that a social enterprise’s active efforts to limit profitability in order to lower costs to its customers or implement more costly but more environmentally-sustainable technology – so long as supportive of the businesses’ primary social purpose – would be considered “profit reinvestment”.] Whilst we wholeheartedly agree that expectations of outsized, simultaneous financial and social returns are unrealistic and that there is a necessity to restrict moral hazard among businesses to prioritize commercial profit-seeking goals above social ones, a stronger dialogue needs to be led concerning the degree of compatibility – or incompatibility if you will – of the pursuit of social as well as financial gain in a given undertaking. ...Or rather, the balancing of the needs and interests of the *beneficiaries of social business* and those of *shareholders who seek at least some modest degree of financial return*. The organizations I represent would like to move the debate away from whether *any* degree of financial gain is compatible with the pursuit of social goals, toward **what social need is being addressed and what level of financial gain – therein - is socially responsible**. To fail to do so will, in our view, not only restrict the flow of the huge latent pool of capital that is available to support this new sector and keep the social impact investor community a very exclusive club. We anticipate it will also negatively affect our ability to attract young, innovative and energetic players to the field.

3. Closing

In summary, I’d like to leave you with 6 brief thoughts:

First, a society with a vivid social entrepreneurship scene is not only more fair... it’s the future!

Second, European welfare systems, especially in Eastern Europe, need this innovation push. We must start using entrepreneurial thinking to address social challenges.

Third, to make this push effective, a broad range of funding and support services needs to be offered.

Fourth, if one accepts this principle, then we **must re-evaluate** and contemplate changes to regulatory and tax frameworks affecting collective investment undertakings and foundations.

Fifth, we need new collaboration networks between private and public sector actors.

And **finally**, social enterprises come in different shapes and sizes. We need to create a space to foster experimentation. We must start with a small back-yard garden before we even contemplate fixing the boundaries of an orchard.

Again, we thank you for your invitation to join this forum and look forward to a continuing constructive dialogue on these topics.