INTERREG SIV

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Draft Private Capital for Social Impact Strategy

Version 1

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Content

Tables and Figures

1. The Interreg SIV Project

Even though the EU unemployment rate is at an all-time low, it is still vital to focus on reducing the risk of long-term unemployment and on facilitating the integration of disadvantaged groups into the labour market. There is an untapped potential for solving these challenges by activating private capital. This is the main goal of the new EU funded Interreg project Social Impact Vouchers – in short, SIV that started in March 2019 and will run until February 2022.

Within the scope of the SIV project, eleven project partners from eight Central European countries will introduce a novel and innovative labour market instrument, aimed to increase the capacities of social enterprises and public stakeholders to leverage private capital for solving social challenges of long-term unemployment. Based on a voucher system, the project will develop an incentive system for companies to hire long-term unemployed and individuals from other vulnerable groups.

The programme will be partly conducted online. For this purpose, the project partners will develop an online platform, aimed to support the implementation of the programme by enabling the matching between job seekers and prospective employers. Furthermore, modules for online coaching and training of both employees and employing companies will also be provided on the platform.

The programme will be financed mainly by private capital. However, additional public financing in form of mixed financing is not excluded. The concrete financial instrument behind the SIV programme will be a social impact fund. The following subsections of this strategy paper will focus on shedding light on what type of social impact funds would be best suited for the purposes of the SIV programme.

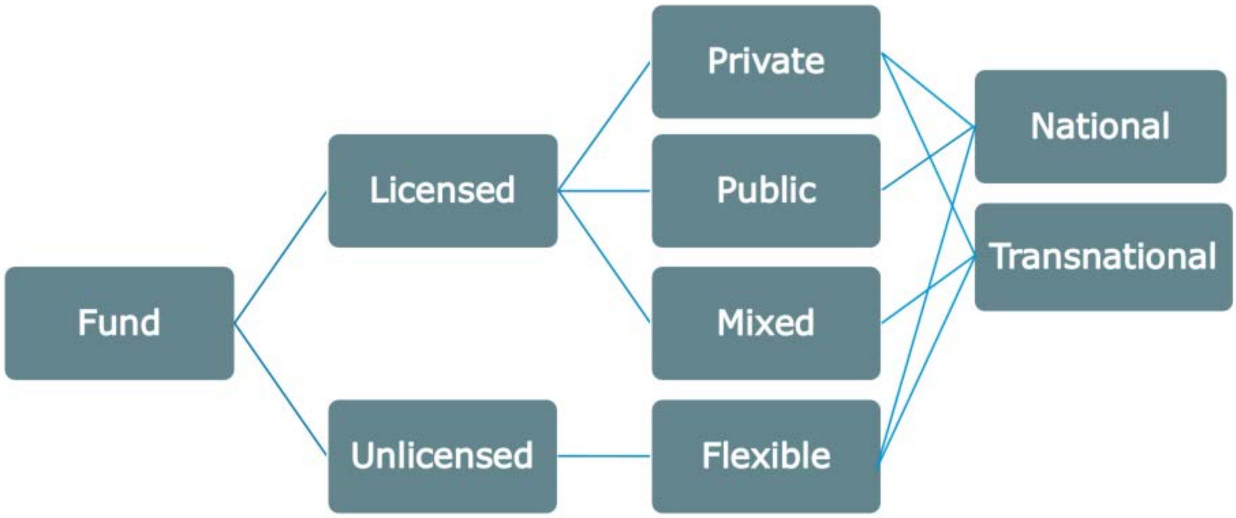
2. Types of Social Impact Funds

Social Impact Funds can be broadly classified based on the following characteristics:

- **Licensed vs. unlicensed** social impact funds
- **National vs. transnational** social impact funds
- **Return-oriented vs. philanthropic** social impact funds.

Subsequently, we will elaborate on the specifics that define each of the mentioned types of social impact funds and, based on this information, we will conclude which type of fund is best suited for the SIV programme.

Figure 1: Types of Social Impact Funds



Source: Own representation of CEF Cooperative for Ethical Financing (PP2) & WU Vienna (PP10)

2.1. Licensed vs. unlicensed Social Impact Fund

As illustrated in Figure 1 above, we can broadly distinguish between licensed and unlicensed social impact funds. Licensed funds are more strictly formalized and define more specifically the sources of their capital as well as the minimal amount to be included in the fund. Thus, licensed funds can either be exclusively privately or publicly financed or can be based on a form of mixed financing. Moreover, licensed funds require supervision from the responsible financial regulators and administration by licensed fund managers. These aspects raise the administration costs significantly, which is why licensed funds usually require investment volumes of at least 10 million EUR. The highly formalized structure is also a reason for the relatively long period of time necessary for the fund implementation. However, once established, licensed funds offer additional possibilities to be combined with other financial instruments, which can be an attractive aspect for investors.

On the other hand, unlicensed funds differ from licensed ones in the sense that they are more flexible and are usually run in accordance to internal agreements as opposed to a set of rules predefined by the responsible financial regulators. Concretely, this means that unlicensed funds are not required to adopt a fully formalized structure and do not have to fulfil certain conditions for including only certain types of capital, be it private, public or mixed. This added flexibility compared to licensed funds guarantees a more cost-saving as well as a more swift implementation of unlicensed funds. In addition, due to their reduced administration costs, unlicensed funds are a suitable choice for funds with a small investment volume as well. Thus, unlicensed funds usually take the form of a non-profit entity that also takes on the role of managing the fund. In order to compensate for the less-formalized structure, unlicensed funds require internal governance as well as clear and transparent procedures. Table 1 gives an overview of the distinction between licensed and unlicensed social impact funds.

Table 1: Features depending on the different types of Social Impact Funds

Licensed Social Impact Funds	Unlicensed Social Impact Funds
Requires licensed fund management company	Requires internal governance and IT platform to ensure transparency and usability
Regulatory complexity	Fully flexible in accordance with internal agreements
Minimum volume required in order to cover high transaction costs	Lower minimum capital requirements and lower transaction costs
Challenge with multi-currency transnational funds	Easier to operate in transnational mode
Long time of implementation	Quicker and easier to implement
Potential support by EU development financial institutions	
Attractive to institutional investors	
Could easily be combined with other financial instruments	
Well structured with clear mandates	

Source: Own representation of CEF Cooperative for Ethical Financing (PP2) & WU Vienna (PP10)

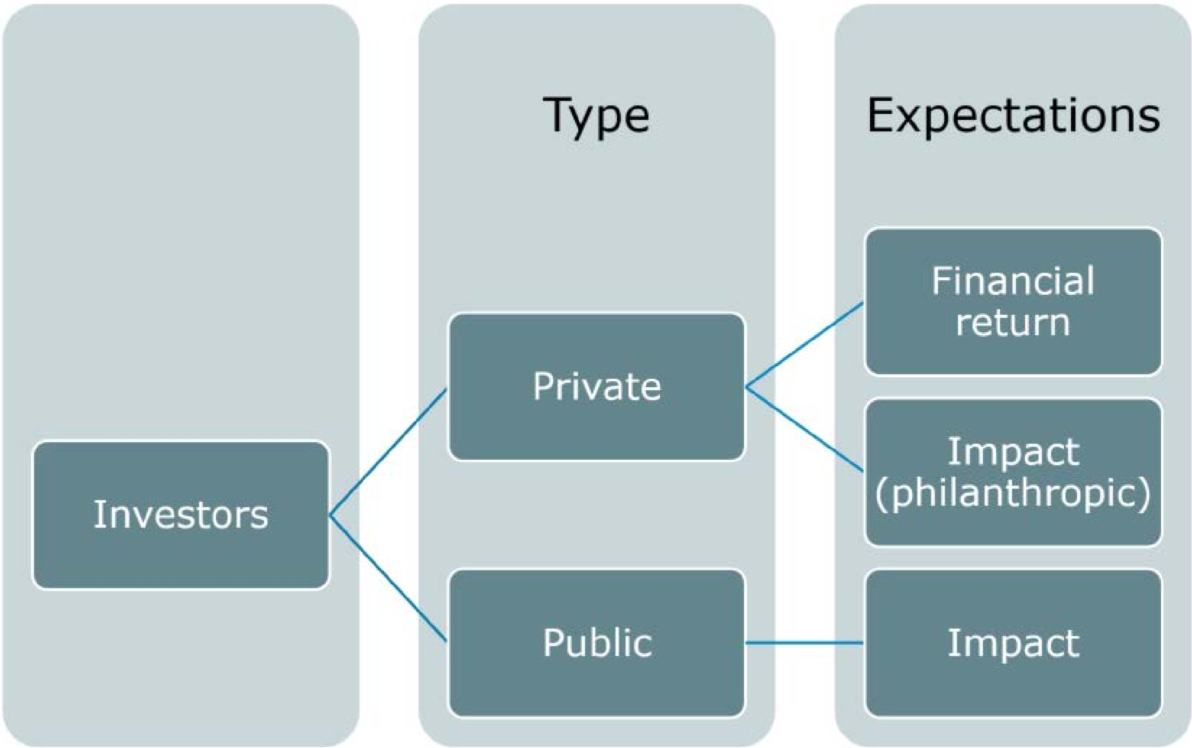
2.2. National vs. transnational Social Impact Fund

Closely related to the type of capital building the fund is also the decision whether the fund can operate on a national or transnational level. While unlicensed social impact funds, due to their increased flexibility in managing their capital, can be easily set up both nationally and transnationally, licensed funds face more restrictions regarding their area of operations (see Figure 1). For instance, in the case of public investors that are active exclusively on a national level, they want to ensure that their funds are used for solving social issues in their respective countries and therefore see transnational funds quite critically. On the other hand, private investors might find it attractive to get involved in transnational initiatives.

2.3. Return-oriented vs. philanthropic Social Impact Fund

The purpose of social impact funds also differs with concern to the profit-dimension. Thus, social impact funds can be either return-oriented with high expectations for financial profit or philanthropic in nature, primarily aiming to achieve social impact. These aspects are also closely related to the type of investors contributing to the fund. As pictured in Figure 2, public investors usually focus on generating a positive social impact, whereas private investors can have different goals. Some private investors such as foundations usually have a philanthropic motivation. Other social investors will expect a financial return. For this reason, certain types of investors are better suited for certain social causes, depending on the market viability and profitability of these causes.

Figure 2: Types of investors, differentiated by capital sources and expectations for investment



Source: Own representation of CEF Cooperative for Ethical Financing (PP2)

The purpose and orientation of the fund is also a determinant for the life cycle of the fund: Return-oriented funds typically generated profits for the investors as well as financial returns to the fund, which enables the fund to be revolving. On the other hand, philanthropic funds are expected to reduce in size over time and therefore are usually only partly revolving or perhaps even non-revolving.

3. Discussion and Decision on type of fund for the SIV programme

In order to reach a decision regarding which type of social impact fund would be best suited for the SIV programme, the project partners first had to discuss and answer the following key questions:

1) What is the realistic amount of funds that we expect to raise in each country?
2) Who are our potential investors? Are they private or public in nature? Or both?
3) What are the return expectations of the investors? Are we aiming for a fully revolving, party-revolving or non-revolving fund?
4) What is the absorption potential of our target group beneficiaries?
5) Are we going for a national or transnational fund?
6) What is the life cycle of the fund?

Table 2 below provides a summary of this discussion and illustrates the expectations as well as strategic orientations of each project partner regarding the fund implementation:

Table 2: Summary of the expectations of each project partner regarding the rough amount of money that can be raised for the fund, the sources of financing and the fund types, by country

Partner Country	Fund size (estimation)	Private/ Public/ Mixed Capital	Revolving Fund: yes/ no/ partly	Transnational/ National Fund	Financial return: yes/ no/ partly
Austria (PP5, PP10)	200 000 EUR	Private, perhaps mixed	Partly revolving	Transnational	No
Croatia (PP2)	100 000 EUR	Public	Non-revolving	Transnational	No
Czech Republic (PP6)	20 000 EUR	Mixed	Party revolving	National	No
Germany (LP, PP9)	2 500 000 EUR	Private	Partly revolving	National, with an option for future embedding into transnational fund	Partly (?)
Hungary (PP4)	100 000 EUR	First public, then private	Partly revolving	Transnational	No
Poland (PP7, PP8)	100 000 EUR, approx. 200 000 EUR (incl. public)	Private, perhaps mixed	Revolving	National	No
Slovakia (PP11)	50 000 EUR	Mixed	Partly revolving	National	No
Slovenia (PP3)	20 000 EUR	Public	Non-revolving	Transnational	No
	Approx. 3 million EUR				

Source: Own representation of WU Vienna (PP10)

As revealed in Table 2 above, all project partners agreed unanimously on **unlicensed social impact funds**, after determining that the minimum amount of money required for a licensed fund (estimated at approximately 10 million EUR) cannot be reached within the scope of the current project. However, all partners agree that the option to maybe later, in a follow-up phase, upgrade to fully licensed funds remains viable.

Secondly, the project partners agreed on establishing **a transnational social impact fund** for the partners in favour of this option (Austria, Croatia, Hungary and Slovenia) and at the same time to also establish **several national funds** for the partners in the Czech Republic, Germany, Poland and Slovakia. For the partners that decided to operate national funds for the time being, the option to perhaps later integrate these funds into the transnational fund was presented and taken into consideration. For the transnational fund, the partners acknowledge certain difficulties as well: Operating a multi-currency transnational fund can be challenging, it is however easier to accomplish in the case of an informal and unlicensed fund compared to a licensed one. In addition, raising public money for a transnational fund can also prove to be difficult.

Finally, all project partners agreed on **philanthropic funds, without any expectations for return**. A key reason for this is the fact that informal funds are usually non-profit entities that are able to receive money back, but cannot issue shares for the investors. Therefore, if the funds should be closed at a later time, the remaining capital would probably need to be assigned to similar missions. However, given that these non-profit entities are able to register certain returns that they would then reinvest into the programme, most project partners see the creation of a **partly revolving fund** as the most realistic option. In contrast, a fully revolving fund is usually difficult to sustain with philanthropic funds, as the fund volume is expected to shrink over time. Two partners envision non-revolving funds, given that they will rely exclusively on public funds that will not be returned. In relation to philanthropic funds with no expectation for financial return, the project partners identify the possible challenge of raising private money from social impact investors, with the exception of maybe charitable foundations.

4. Fund implementation strategy and next steps

Table 3 below describes the steps and activities needed for establishing a social impact fund, for both licensed and unlicensed funds. In the case of an unlicensed fund, as it was agreed upon for the SIV programme, the focus will lie on identifying a suitable legal entity that is profiled as not-for-profit and that can assume the role of fund manager. Next, clear and transparent rules and procedures for implementing the voucher systems will have to be defined internally. Closely related to this is the further elaboration of the internal fund management structures, for instance by creating a platform for increased transparency and by defining internal organisational structures. Therefore, the activities that are required for establishing an unlicensed fund are more organisational and technological in nature. Once the framework surrounding the fund structures and processes is defined, potential investors will subsequently have to be identified and addressed.

Table 3: Description of the activities required for fund establishment, differentiated by fund type

Licensed Social Impact Funds	Unlicensed Social Impact Funds
Identification of required size and investment potential (gap analysis)	Identification of legal entity under which fund will be managed
Identification of fund manager and most suitable jurisdiction for fund establishment	Definition of internal rules and procedures for selection of beneficiaries
Identification of investors	Identification of investors
Creation of prospectus, investment mandates and legal framework	Creation of platform and organisational structures

Other legal and regulatory activities	
More legal compliancy type of work	**More organisational / IT type of work**

Source: Own representation of CEF Cooperative for Ethical Financing (PP2)

In conclusion, the project partners will next deal with establishing a framework and legal structures for both the transnational fund and the national funds and will start the application process for the fund management. Related to this aspect is also the definition of management procedures, roles and responsibilities for operating the fund, such as deciding on programmes for each fund, establishing rulesets for eligibility and decision-making as well as for controlling, monitoring and evaluation of the fund. Finally, once these aspects have been cleared, the partners will focus on concluding the approval process for the fund management and on commencing the activities within the voucher programme. Some of these steps are already being carried out and some are to be completed by spring 2020.