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THE NEED FOR SOCIAL FINANCE TO FUND SOCIAL INNOVATIONS

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Abstract

In recent years, social finance has been subject to a special interest in scientific discussion globally as a counterpart to commercial finance to fund social innovations through various forms of organizations.
Indisputably, organizations or individuals who intend to introduce social innovations are marginalized in terms of the availability of commercial finance, due to the risks to the return on investment.
This paper provides an overview of the conceptual framework of social finance and examines its influence on the introduction of social innovation, especially the Macedonian landscape, to answer the question whether social finance is most suitable for the introduction of social innovations that are essential and become growingly present in modern socio-economic systems.

Keywords: social finance, social finance instruments, social innovation.

Social finance

In the capitalist socio-economic system, social enterprises are, on the one hand, facing large and somewhat emotional market actors, which is defined as the most efficient mechanism for allocating resources or the invisible hand[1] (Fiti, T., 2014, p. 35), and on the other, the government in the so-called mixed economies[2] (Fiti, T., 2014, p. 35), which in the less developed economies may be an obstacle for their action and successful operation.
To clarify the financing of social enterprises, it is worth noting that the overall financial process includes available financial instruments, finding the right social investor, approaching the social investor, screening and due diligence process, negotiating the financing terms, working with investors, including performance measurement, and ultimately exit consideration (Achleitner, A.K., Heinecke, A., Schöning, M., Noble, A., 2011, p. 9).

Sources of financing social enterprises

Social investments include financial capital (money), social capital (networks), and human capital (expertise and skills) (Nicholls, S. & Pharoah, C., 2008, pp. 314-317).
The various models of social enterprises imply various sources of finance (see Figure 1).

[1]According to Smith, the market skillfully allocates resources to points of productive use, and the owners, who are allowed to maximize the wealth indirectly or, as Fiti notes, unconsciously contribute to the community.
[2]The term mixed economies refer to combined involvement of the market and the government segments.

Fig 1. Dimensions of financing social entrepreneurship

Source: Adapted from Nicholls, A. (2006), "Introduction" in Social Entrepreneurship. New Models of Sustainable Social Charge, edited by Aleks Nichol, Oxford University Press, p. 12.

Guidelines are recommended for strategic structuring of the four pillars of financial sustainability of social enterprises: reasons (startup capital, working capital, development capital, and capital for various operational procurements), amount of required funds (short-term and long-term financial planning), type of source (investors, traditional banks, donations, various grants, memberships, own production, etc.), and manner of acquisition (legal regulations, accessibility and availability, etc.)[3].

Muhammad Yunus points out that for founding the Grameen Bank he used external sources for financing, including the World Bank, various grants, donations, etc., in order to achieve his larger goals, to grant loans to a larger group of citizens who, according to the commercial banks' criteria were not creditworthy (Yunus, M., 2006, p. 43).

The financing of social enterprises largely depends on the model, as well as on the legal and normative framework decided by the social entrepreneur. The range of financial resources for social enterprises is wide, both of internal and external nature.

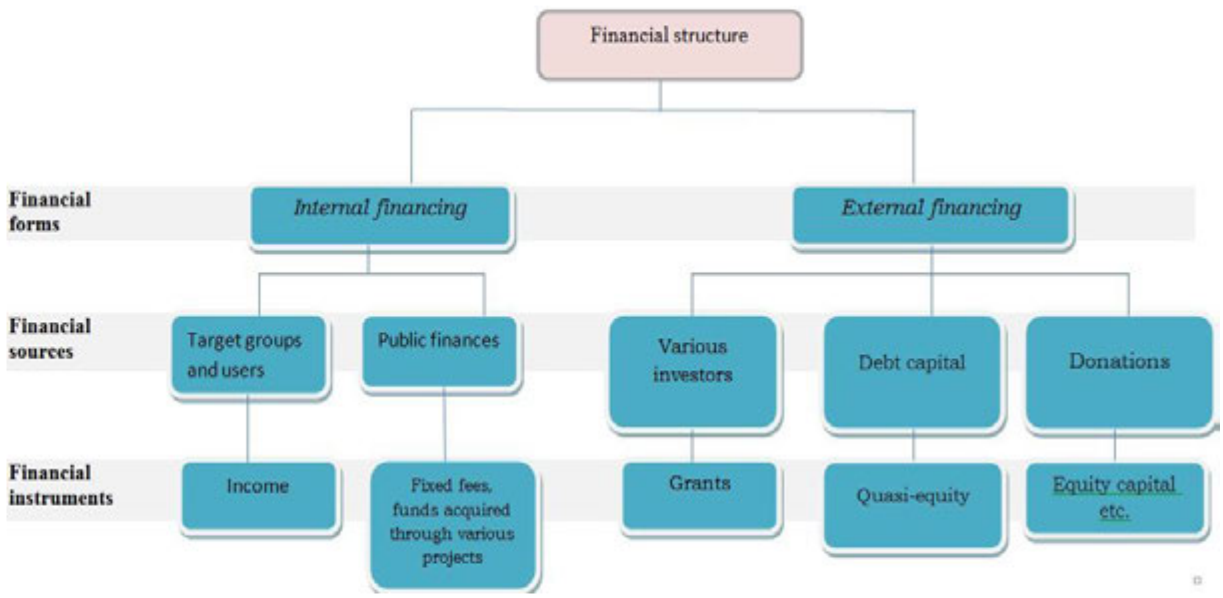

Fig 2. Financing of social enterprises

Source: Spiess-Knafl, W. & Achleitner, A.K. (2012), "Financing of Social Entrepreneurship ", in Volkmann, C. K.; Tokarski, K.O.; Ernst, K. (Eds.), Social Entrepreneurship and Social Business, Springer Gaber, p. 158.

[3] http://redochre.org.uk/wp-content/uploads/2012/03/Finance-Toolkit-for-Social-Entrepreneurs_May-2011.pdf.

External financing includes the following financial sources: fund raising through various investors (who do not expect, partially expect, or expect to earn money from funds invested in newly established social enterprise), through grants, donations, debt financing, mezzanine capital, hybrid capital, etc.
Internal financing includes product/service fees charged to target customers, or public sector, membership fees, fixed fees, funds acquired through various projects, etc. (Spiess-Knafl, W. & Achleitner, A.K., 2012, pp. 158-160).
Financial instruments of social enterprises include enterprise income, financial compensations and finances from various projects - as internal sources, and grants, donations, sponsorships, debt financing, mezzanine capital, etc. - as external sources of financing (see figure 2).
Research conducted for this purpose concludes that while commercial banks and other types of financial institutions include microfinance with a social component, the creditworthiness of customers is in the foreground, as well as the high interest rates as one of the main challenges, i.e., no other model with a social element is offered.

Financial institutions in the social capital market

With the development of social entrepreneurship, the attention to social finance is increasing and goes beyond the traditional framework of financing, where the most common financial actors, as well known, include commercial banks, investment banks, stock exchanges, risk capital funds, investment funds, etc., and their counterparties in the social capital market, such as value banks, social investment advisories, social stock exchanges, philanthropic funds, social finance funds, etc. (see figure 3)

Institutions in the Traditional Capital Markets	Institution in the Socijal Capital Markets
Commercial Banks	Value Banks
Investment Banks	Social Investment Advisers
Stock Exchanges	Social Stock Exchanges
Venture Capital Funds	Venture Philanthropy Funds
Investment Funds	Social Investment Funds
Research & Rating Agencies	Funding Consultancies

Fig 3. Comparison of institutions participating in traditional capital market and the social capital market
Source: Achleitner, A.K., Heinecke, A., Schöning, M., Noble, A. (2011), "Social Investment Manual. An Introduction for Social Entrepreneurs ". Available at file:///C:/Users/Cutka/Downloads/SSRN-id1884338.pdf., p. 6

EU and national support

The role of the public sector is an influential factor for the successful development of social entrepreneurship, given the power to create adequate conditions, from legislation to financial support of social initiatives and social market development. The European Union, through its regional policy, takes measures to support job creation, business development, sustainable economic growth, and to improve citizens' quality of life. Almost a third of the total EU budget has been set aside for the goals planned for the period 2014-2020. Such cohesion policy is delivered through three main funds, namely the European Regional Development Fund (ERDF), the Cohesion Fund (CF), and the European Social Fund (ESF). Here, we could also mention the European

Agricultural Fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund (EMFF)[4]. The European Social Fund was set up to improve employment and education opportunities, i.e., to improve the situation of the most vulnerable people at risk to poverty. For example, more than EUR 80 billion is earmarked for that purpose in the EU member states between 2014 and 2020, with an extra of EUR 3.2 billion allocated to the youth employment initiative. The EU cohesion policy will focus on the following thematic objectives: promoting employment and supporting labour mobility, promoting social inclusion and combating poverty; investing in education, skills and lifelong learning; enhancing institutional capacity of the public administration. In addition, 20% of the investments will be committed to combating poverty (Regulation (EU) No 1304/2013). The EU also offers support to candidate countries, such as Macedonia. The support is provided through the national governments, which play the role of mediators and implementers of such policies, thus creating internal support through various national programs.

Given that a large portion of the Macedonian population at risk of poverty is engaged in agriculture, primarily for own needs, and given the natural conditions agriculture can be a competitive branch primarily for organic production, efforts are being made to support this segment. In addition to the Ministry of Agriculture, Forestry and Water Economy, special agencies have been established such as the Agency for Financial Support in Agriculture and Rural Development (for efficient management of the EU Instrument for Pre-Accession Assistance and the Budget of the Republic of Macedonia), as well as the Agency for Promotion of Agricultural Development (for providing agricultural advisory services for quality production with economic justification). This financial support is provided through the IPARD Programme[5] and through the National Program for Financial Support of Rural Development. The support consists of advisory services, direct financial assistance in the form of subsidies, investment funds, etc. The analyses in this paper indicate that the weaknesses of such support include complex bureaucratic procedures and inaccessibility for marginalized groups of citizens, political and other influence in the approval procedure, largest utilization by large companies, inaccessibility for start-ups even to earmarked programs (young farmers), which requires from the entrepreneur to make the investment, and then to be reimbursed, etc.

Special research[6] was conducted for the disbursement of funds from the Agricultural Credit Discount Fund[7], available for institutions responsible for agricultural economies and for small and medium enterprises, with favourable interest rates (4% through commercial banks and 6% through savings houses). The discount difference for the included banks and savings houses is provided by the European funds and the state budget funds. Weaknesses: strong political influence by pointing to preferable beneficiaries of such funds, inaccessible for start-ups, strict creditworthiness standards, etc.

As a result, some of the barriers social entrepreneurs face within the search for financial capital in Macedonia include:

- poor accessibility to funding sources,
- failure to support the founding phase by the financial institutions,
- misunderstanding of the concept of social entrepreneurship by the institutions that are potential financiers,
- non-profit purpose of social enterprises (commercial banks are interested in the capacity to generate profit to be able to repay the debt with interest) [8],
- political and other influence on the accessibility to various types of government support, etc.

In the research conducted with owners of social enterprises and non-profit organizations in Macedonia, there

[4]http://ec.europa.eu/regional_policy/en/policy/what/investment-policy/.
[5] Instrument for pre-accession for rural development.
[6]The data on the disbursement from the Agricultural Credit Discount Fund were obtained through interviews with PR officers in the involved commercial banks.
[7]http://www.mbdp.com.mk/index.php/mk/kreditiranje/zemjodelstvo.
[8]A mitigating factor is that it is a sustainable model of social enterprises.

was a question about the sources of finance used in the founding phase and the answers included own funds, loans, investors, donors, government subsidies, European funds, social investment funds, and alternative sources. Most of them answered that they used own funds and funds of donors, combined sources, European funds, and alternative sources. The results show that loans, as commercial bank products, are inaccessible for non-profit organizations, and social enterprises, as abovementioned, according to the existing legislation cannot yet acquire the status of legal entities but appear in the types of companies. Another interesting fact is that commercial banks do not support start-ups, nor do they recognize the concept of social entrepreneurship[9]. It is interesting that the Fund for Innovations and Technological Development has a special public call for support of social entrepreneurship. At the last public call in 2021, the total budget for social innovations amounted to MKD 6.000.000,00.
It is also worth noting that when choosing the right investor, depending on the size of the planned investments, it is necessary to consider the type of activities it supports, the geographical focus, the type of financial instrument, and then to choose ways to establish successful business cooperation (Achleitner, A.K., Heinecke, A., Schöning, M., Noble, A., 2011, p. 12). The social entrepreneur should apply a serious approach in their requirements through a structured presentation of the planned investments and the necessary funds for their implementation, as well as ways to manage them, and, in the case of debt financing, to provide a way for its repayment.
In Macedonia, there is very small, almost non-existent, support in the initial phase of the founding of enterprises, where social entrepreneurs are deprived of the opportunity for financial support.

Concluding remarks with recommendations

Regarding the financing of social enterprises, it is worthy to note that the overall financial process includes finding available financial instruments, finding the right social investor, approaching the social investor, screening and due diligence process, negotiating the financing terms, working with investors, including performance measurement, and ultimately exit consideration (Achleitner, A.K., Heinecke, A., Schöning, M., Noble, A., 2011, p. 9).
During the paper elaboration, the following concluding observations were made:

- An essential segment in assessing financial feasibility of a conceived social business idea is to determine the start-up capital or total assets necessary for commencement.
- When determining the start-up capital, of no less importance is the forecast of the return on investment, financial operations in the initial period, and defining the investment value.
- The initial investment is interpreted as a one-time cost needed to launch a business (Marioti, S., Glackin, C., 2012, p. 3), and the amount of costs primarily depends on the type of activity, i.e., products/services to be offered.
- Social investment includes financial capital (money), social capital (networks) and human capital (expertise and skills) (Nicholls, S. & Pharoah, C., 2008, pp. 314-317).
- The market orientation of social enterprises makes them more prone to economic risks, especially in the first phase of establishment.
- With the development of social entrepreneurship, the attention to social finance, which goes beyond the traditional framework of financing, is also increasing.
- The following can be found on the social capital market: value banks, social investment advisories, social stock exchanges, philanthropic funds, social finance funds, etc.

[9] Due to the lack of special legislation on social entrepreneurship, social entrepreneurs who intend to establish a social enterprise with a business model, decide to establish a company and make an internal decision to achieve social goals. Therefore, some of the respondents were owners of such enterprises, and should be acceptable to banks for debt financing.

- The role of public administration is an influential factor for successful development of social entrepreneurship, given the power to create adequate conditions, from legislation to financial support of social initiatives and the development of social market.
- Access to finance and financial sustainability are one of the most pronounced potential risks in social enterprises.

The traditional financing system still prevails in Macedonia, and it is recommended that the entities that decide to establish a social business use them or turn to the accessible financial sources for financing social investments abroad.

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