

## Note : for a recognition of social enterprises in the review of the General Block Exemption Regulation

### Executive Summary

**Social enterprises (SE), by their weight and the variety of their actions, represent a major challenge for a sustainable, innovative, socially inclusive and ecological European economic growth in the different Member States.** According to the European Economic and Social Committee (EESC), there are 2.8 million SE. They represent 8% of GDP in the EU and 13.6 million workers, or 6.3% of employees in Europe. From very small enterprises (VSEs) and small and medium enterprises (SMEs) to large groups of the social economy, they operate in every sphere of activity. SE are characterized by limited profitability: they are managed according to common characteristics, values and principles such as the primacy of the person and the corporate purpose over capital, voluntary and open membership and democratic governance. Profits are reinvested in the creation or maintenance of jobs or in the development of activities in line with the company's corporate purpose.

Due to the innovative nature of many social enterprises, the sectors covered by their activity are wide-ranging. European SE are particularly active in the social integration of disadvantaged people; in social services of general interest; land-based industries and the environment; cultural, touristic, recreational activities and sports; etc. They are active in segments that are little or not covered by for-profit companies and have a limited impact on competition. **Through their activities and the way they operate, social enterprises therefore contribute to the achievement of many key Union objectives, and notably a just environmental transition for all Europeans.**

However, **European SE are facing structural difficulties in accessing financing as a result of the social finance market failure.** The reasons for these difficulties are numerous and have a variety of causes. Examples include the usually small size of SE, the fact that their securities are not listed, their low return on capital, which makes them less attractive to investors, and barriers to access to credit (*see the memorandum below for more details on the barriers*). These difficulties hamper their development and thus their ability to achieve their social objective. That is why it is necessary for SE to be able to benefit from support for access to financing in a sustainable way.

However, SE do not benefit from a special recognition under the GBER; they are assimilated to SMEs (when they meet the conditions). Under Article 21 of the GBER (and draft Article 56e that defines the conditions applicable to aids contained in financial products that benefit from the support of the InvestEU Fund), the aids from which SE may benefit are therefore limited to companies with less than 7 years' seniority and to a total amount of €15 million.

- The temporal limitation of 7 years of seniority is justified for SMEs because it is an aid for the launch of a company active on a market where it could harm fair competition by benefiting from State aid without any time limitation. To the contrary, **in the case of SE, the aid is not justified by the start of their activity but by the structural market failures** they face in terms of access to financing, and this throughout their lifetime (not just for a start-up period), as recognized by the Court of Justice of the European Union and by the Commission.
- Concerning the €15 million cap on total aid, the condition is not appropriate for SE. As with the time limitation, social enterprises' need for support is not cyclical but **structural**. Indeed, social enterprises are unlisted and achieve lower margins. **The lower remuneration of investors impairs SE's attractiveness and causes difficulties of access to equity capital all along their life.** This is all the more true in the many capital-intensive sectors where social enterprises carry out their social objective:

renewable energies, social housing, sustainable agriculture... The cap planned on the life time of the enterprises prevents lifelong support that social enterprises require.

In light of this unsuitability of the SME rules for SE, Finansol proposes to create **a specific framework for SE**, distinct from that applicable to SMEs, regarding the conditions for exempting risk finance aid schemes in favor of SMEs provided for in Article 21 and draft Article 56e. They are in line with (i) the objectives of the GBER; (ii) the current and recent European initiatives around the development of SE in Union countries; (iii) current Union strategic objectives; and (iv) the case law of the Court of Justice of the European Union.

## 1. Introduction of a definition of social enterprises in the GBER

In order to frame specific exemption conditions for SE, Finansol proposes to draw upon a preexisting definition to which regulatory effects are already attached in the Regulation on European social entrepreneurship funds (Regulation No. 346/2013, Article 3 d)).

## 2. Removal of the limit of 7 years of maximum seniority

In order to address the structural market failures that hamper their access to financing, SE, provided that they meet the criteria of the above-mentioned definition, should be eligible for aid all along their business and independently from a start-up period.

## 3. Amendment of the cap on the aid amount

SE need this cap to be significantly higher than that enjoyed by SMEs, which are in a much more favorable situation for access to finance.

Account should also be taken of the specific financing needs of sectors where a high level of equity capital is required, with the difficulty of identifying the latter precisely without making unjustified exclusions.

This radical solution does not, however, leave the Commission powerless, since it may, on the occasion of the periodical review of the GBER, decide to reinstate one in case the conditions of access to finance for social enterprises were to improve to such an extent that they would become similar to those enjoyed by other businesses.

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In the context of the targeted review of the General Block Exemption Regulation (“GBER”) concerning the extension of the scope of the GBER to national funds combined with certain European Union (“EU”) programs, Finansol calls on the European Commission (the “Commission”) to recognise the existence and role of social enterprises as a category distinct from SMEs, in order to allow these actors, at the very least, to benefit from a longer period and a higher threshold for the amount of aid than those currently applied to them because of their current assimilation to SMEs (Article 21 GBER / draft Article 56e).

This argument is based on the idea that, because of their limited profitability, social enterprises are not attractive to investors and their financing is structurally flawed. In order to address this market failure, social enterprises require sustained public support (mainly in the form of guarantees given to investors or tax incentives to entry), and there is a need to move towards a general solution applicable to all social enterprises. The objective of this memorandum is to show that all the elements are already present to justify more favourable conditions than those applying to conventional SMEs.

Thus, social enterprises have a different purpose from that of traditional SMEs, which is to meet needs not met by private initiative (1). Responding to such needs implies a different, less attractive business and investment model than that of traditional SMEs, and SE therefore face financing difficulties. These obstacles are intrinsically linked to their purpose and imply a structural need for State aid (2). The current regime (as well as that provided for in Article 56e of the draft amended Regulation) does not, however, take into account the specificities of social enterprises compared to traditional SMEs and is therefore unsuitable for them (3). It is therefore necessary to amend the GBER in order to adapt the system of State aid to social enterprises (4), in line with the spirit of the GBER and European initiatives (5).

## 1. SOCIAL ENTERPRISES RESPOND TO NEEDS NOT MET BY PRIVATE INITIATIVE

### 1.1 SOCIAL ENTERPRISES, A KEY RESOURCE FOR THE INTERNAL MARKET

Social enterprises, by their weight and the variety of their actions, represent a major challenge for a sustainable, innovative, socially inclusive and ecological European economic growth in the different Member States. Since the adoption of the Social Entrepreneurship Initiative by the Commission in 2011, 16 Member States have adopted a new specific legislation in this field and 11 Member States have developed strategies or formal policies to support the development of social enterprises (Portugal, Romania, Latvia, etc.).<sup>1</sup>

According to the EESC own-initiative opinion<sup>2</sup> of 19 June 2019 (point 2.1.1):

*“It [the social economy] comprises 2.8 million enterprises and organisations in different forms – including cooperatives, mutuals, social enterprises, associations and foundations<sup>3</sup> – engaged in economic activity, representing 8% of GDP in the EU and 13.6 million workers, or 6% of employees in Europe. Social economy entities, from very small enterprises (VSEs) and SMEs to large groups, operate in every sphere of activity.”*

According to these figures, the average European social enterprise employs 5 members of staff, making it a micro enterprise in the European sense, with all its characteristics and problems.<sup>4</sup> As micro-enterprises have no

<sup>1</sup> European Commission, [Social enterprises and their ecosystems in Europe - Comparative synthesis report](#), January 2020.

<sup>2</sup> EESC, A. Coheur, Own-initiative opinion “Towards an appropriate European legal framework for social economy enterprises”, 19 June 2019, INT/871.

<sup>3</sup> In France, there are about 165,000 employer entities or enterprises in the social economy: 155,000 associations (93%); 8,000 cooperatives (5%), 800 mutual societies (0.5%), 500 foundations and about 1,500 social utility companies.

<sup>4</sup> In France, the average number of staff employed in the 200,000 social economy establishments employing employees is 11.8, broken down as follows: 11 for an association, 12.1 for a cooperative, 20.5 for a mutual society and 57.1 for a foundation. They are therefore for the most part VSEs in the European sense and SMEs in the sense of French public accounting.

market power, the fear of creating a competitive gap in the internal market must therefore be minimized from the outset and all subsequent developments will demonstrate this. The EESC opinion of June 2019 therefore rightly calls for greater legal recognition of this type of enterprise. Today European law is based on a *summa divisio* which recognizes only two types of enterprise, the for-profit enterprise and the not-for-profit enterprise. It is largely unaware of the existence between these two categories, in several Member States, of another category of enterprise: the limited profit enterprise.

The EESC opinion also recalls the distinction between a limited profit enterprise and a for-profit business (point 1.2):

*“Social economy enterprises and organisations are run according to shared features, values and principles such as the primacy of the individual and the social objective over capital, voluntary and open membership, and democratic governance. They seek not to maximise short-term profits, but to ensure their long-term viability. Profits are reinvested in creating and maintaining jobs or in developing activities that pursue the social objective, or else are distributed among the members on the basis of their personal contributions.”*

As a result of this voluntary membership, there are 232 million members of cooperatives, mutual or associations in the European Union, which represents more than one out of every two citizens.

Generally speaking, social enterprises have strong local roots and contribute to territorial cohesion through the local services they provide, including in neglected or disadvantaged areas. Through their activities and the way they operate, social enterprises therefore contribute to the achievement of many key EU objectives, including a just environmental transition for all Europeans. Their social activity also plays a role as a social shock absorber in the event of a crisis, alongside public measures, because these companies are more resilient to shocks of all kinds that can affect companies in general. In France, for example, it has been shown that the social economy plays a counter-cyclical role in job creation: in times of recession, it creates more jobs than the market economy, and this has been proven again between 2009 and 2018. In their social mission, they are also increasingly integrating the 17 United Nations sustainable development goals (SDOs) and contributing to their achievement.

Social enterprises are often at the origin of transformations in lifestyles, production or consumption patterns. They play a pioneering role in society as social innovators, relying on a collective mobilisation of citizens, whereas “traditional” SMEs mainly develop technological innovations and mainly rely on individual consumerism. Numerous innovations are to their credit (sustainable or organic agriculture; promotion of the circular economy and short circuits as opposed to the globalization of supply chains by for-profit companies; local currencies, microcredit and social finance; collection, recycling and reuse of waste (clothing, furniture, etc.); solidarity and intergenerational housing; neighborhood authorities; soft mobility; renewable citizen energies, etc.). Social innovation, which is more on the supply side, consists in providing new responses to unsatisfied social needs by modifying organizational methods and moving services out of the family or informal economy and into the formal economy (childcare; education; assistance to the elderly or dependent persons, etc.).

## 1.2 THE ACTIVITY OF SOCIAL ENTERPRISES TAKES PLACE IN AREAS WITH LITTLE INVESTMENT FROM THE PRIVATE SECTOR

Most social enterprises operate, for the majority, in market segments where there is little private initiative. Thus, social enterprises do not compete with the activities of private enterprises and target a different audience who would not otherwise have access to these basic services. Often, they have “opened up” markets by shifting an activity from the informal to the formal sector and it is subsequently the public or private sector, and sometimes both, that come to compete with them (nursery; homes for elderly people; fair trade shops; waste recovery and recycling, etc.).

Because of the innovative nature of many social enterprises, the sectors covered by their activity are very diverse and vary from country to country. According to a 2015 study by the European Commission<sup>5</sup>, European social enterprises are active:

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<sup>5</sup> [“A map of social enterprises and their eco-systems in Europe”](#) (2015), European Commission.

- in the social integration of disadvantaged people (such as the professional integration of the unemployed or the disabled);
- in social services of general interest (such as long-term care for the elderly and disabled, education and childcare, employment and training services, social housing, health care and medical services);
- in other social and community services, e.g. youth advice or support, microfinance, temporary housing for the homeless, etc.;
- public services, e.g. maintenance of public spaces, transport services, waste collection, rehabilitation of ex-offenders, etc.;
- land-based industries and the environment, e.g. reduction of emissions and waste, recycling, renewable energies, etc.;
- cultural, touristic, and recreational activities and sports;
- solidarity with developing countries (e.g. through the promotion of fair trade).

To illustrate this, a few significant French examples can be cited.

### **The example of social housing**

Part of the population remains poorly housed or even homeless because the market does not provide a response to this problem that is compatible with the income of those concerned (rent and charges too high despite the existence of aid, which, moreover, is not always requested by the most vulnerable). In France, several associative groups (*Habitat & Humanisme*; *SNL-Prologues* which was founded by *Solidarités nouvelles pour le logement*; *Solifap* which was created by the *Fondation Abbé Pierre*...) provide solutions to this problem by financing the construction or renovation of housing which is rented at around €6.5 per square meter. In order to develop this offer aimed at very vulnerable groups, social enterprises have had to be more inventive in order to multiply the sources of funding that enable them to get around the difficulties they may encounter with "traditional" bank players: the funding issues are therefore intrinsically linked to the ability of enterprises to respond to societal challenges.

This offer, which has no equivalent on the market, is made possible by the fact that these players finance their programs with a high proportion (around 40%) of equity capital that is not or very poorly remunerated (see 1.1.2.1), which enables them to lower the rent to make it accessible to the most disadvantaged, since the rest of the financing is provided by a public subsidy (35% to 40% of the cost of the program) and the use of debt on preferential terms from the *Caisse des Dépôts* (20% to 25%). However, it is still necessary to be able to raise very substantial equity capital, which implies setting up specific mechanisms to achieve this. The provision of housing gives rise to social support by volunteers and the renting out of housing is often carried out by a social real estate agency whose status is regulated by law, which distinguishes it from market services.

This model exists in other Member States: *Habitat et Humanisme* is, for example, established in Belgium and Luxembourg.

### **The example of agricultural land**

This model used for social housing has also been extended to agricultural land in order to maintain peasant agriculture in neglected territories (*Lurzaindia* in Corsica, which acquires land and buildings threatened with losing their agricultural use in order to rent them out to peasants who, through stable, long-term leases, undertake to respect the principles of peasant agriculture, i.e. agriculture that is local, on a human scale, provides employment, respects natural cycles and is involved in the life of its territory), to support family farming in difficulty (*Terrafine* which does not remunerate shareholders) or to encourage the installation of young farmers committed to organic farming (*Terres de Liens* which does not pay dividends to investors but slightly revalues the value of the capital share from time to time).



## **The example of the reintegration of the long-term unemployed**

Another interesting example is given by initiatives aimed at putting unemployed people back on the road to professional integration. Some associative groups have set up companies whose main objective is to employ people who are not or no longer able to enter the labor market and who are offered a part-time job (half-time in general) in order to regain self-confidence and reacquire a profession. With the aim of maximizing the employment of people excluded from the labor market<sup>6</sup>, they are active in various fields such as the recycling of clothing, furniture, waste, maintenance of green spaces, peri-urban market gardening... and also use savings to finance their land acquisitions or their working capital. In addition, they benefit from public assistance for the remuneration of employees when they are not in employment. The *Jardins de Cocagne* thus regularly call on private investment to acquire land on the urban periphery in order to open market gardening activities that meet, in addition to the main social objective of a return to employment, the objectives of a balanced diet in schools or for the elderly, of public health, of short circuits that respect the environment... No private for-profit company intervenes in the food production market under such conditions.

## **The example of energy communities**

In the European legislative package "Clean Energy for all Europeans", it is recognized (recitals 70 and 71 of Directive 2018/2001) that citizens' initiatives for renewable energy production contribute to "local acceptance of renewable energy and access to additional private capital, which results in local investment, more choice for consumers and greater participations by citizens in the energy transition" and can meet this need precisely thanks to their citizen dimension. Indeed, their main purpose are economic, social and environmental benefits for the territories and not a quest for profit. Some of them are social enterprises (*Enercoop* in France, see European network [RESCOOP](#) for other examples). In order for energy communities to be on an equal footing with large producers, the package also justifies that they should have access to state aid.

## **The example of ethical finance and microfinance**

In the field of finance, *La Nef*, the first bank claiming to be an ethical bank, has been calling on the savings of private investors since 1999 to finance projects of an environmental (organic farming, environmental protection, etc.), social (integration companies, social housing, etc.) or cultural (artistic activities, cultural publishing, etc.) nature. It does not finance any project that has a negative impact on man and the environment. Applying the principle of transparency, it publishes every year the list of the loans it has granted and their conditions. Along with depositors' deposits, this is the bank's only resource for making loans. Depending on their nature, the units are remunerated at the rate of inflation or 200 basis points above inflation, but the subscriber may only purchase units of the second category if he or she has already subscribed for the same number of units of the first category. The European Federation of Ethical and Alternative Banks (FEBEA) brings together European banks that share these principles.<sup>7</sup>

Still in the field of finance, many funds raise capital in France to provide microcredit institutions active in the South (SIDI, which does not distribute dividends and does not reassess the value of the shares, *Oikocrédit*, which pays a maximum interest rate of 2%) or to acquire shares in social enterprises in the South in order to support their long-term growth (FADEV; *MicroFinance solidaire SAS*, which belongs to the association group *Entrepreneurs du monde* and finances 85% of women's entrepreneurship).

<sup>6</sup> This objective leads this type of company to make different management choices from those of for-profit companies. For example, these enterprises do not mechanize waste collection or sorting activities, which limits the amount of investment in equipment.

<sup>7</sup> See <http://febea.org/>



At EU level, many not-for-profit microfinance institutions fulfil a social mission by keeping interest rates low for borrowers (they do not cover their costs with interest charges). By ensuring financial inclusion, they act for social inclusion.<sup>8</sup>

## **The case of a social economy group: the SOS group**

Founded in 1995, the SOS Group, which presents itself as the leading social enterprise in Europe, has a turnover close to €1 billion and employs 18,000 people. However, these high figures are misleading because this group is in fact a federation of social activities operating in a multitude of sectors where its weight remains modest if not marginal: originally focused on the fight against addictions (drugs...) or serious illnesses (AIDS/HIV), it has extended its activities to child protection (nurseries, sports activities; accommodation for children or adolescents at risk), private not-for-profit hospitalization (by running clinics, especially in neglected areas or medical deserts), integration through economic activity with some 15 integration enterprises operating according to the group "in very varied sectors" with 45 establishments throughout the country, support for people with disabilities (by managing specialised establishments), reception of migrants and asylum seekers (by managing "CADA" [accommodation centres for asylum seekers]), reception of the elderly (by managing 62 EHPAD [*Etablissements d'Hébergement pour Personnes Agées Dépendantes*]), reception of the homeless, culture, finance (in 2010, for example, it created an investment fund), The "*comptoir de l'investissement*" that later became INCO, which is also currently developing social enterprise incubators in several developing countries and which has left the orbit of the group; it has also created a subsidiary that incubates social enterprises and takes shareholdings to support their development over the long term, and consulting in the field of the social economy by drawing on the expertise held in a very large number of social professions. Its international activities consist in supporting local actors in forty-four countries, by sending volunteers, organizing trainings and capacity building activities in the fields of health, disability, environmental protection and access to education for all. The latest initiative that illustrates its deliberately off-market positioning, during the "*Gilets jaunes*" crisis, the group launched a program in September 2019 to reopen 1,000 *cafés* in small towns, in order to recreate a bond of sociability in neglected areas. Today, it presents itself as having 8 distinct sectors of activity, not to mention its transversal activities: Youth, Employment, Solidarity, Health, Seniors, Culture, Ecological Transition, International Action. The only common factor common to all its activities, claimed by this group, is the fight against social exclusion. It is of course unique in the for-profit private sector, which is not interested in customers with low purchasing power. In none of its many business lines does the Group hold a significant position in any market, which are highly fragmented and characterized by the coexistence of public, private and private not-for-profit entities. By way of illustration, private not-for-profit hospitalization now accounts for only 10% of the number of beds and is held by hundreds of congregations, foundations or associations which most of the time manage only a few local establishments. The dominant player has become the public hospital, ahead of for-profit private hospitalization (estimated market share of 25% of the hospital supply with more than 1,000 establishments and a few large groups), far ahead of private not-for-profit hospitalization, which is very fragmented.

Social enterprises respond to needs not met by private initiative with a limited impact on competition. In view of the response of social enterprises to the challenges of increasing wealth and income inequalities in Europe, limiting in time (7 years here) the duration of the support that can be given to these social enterprises is an obstacle to the sustainability and effectiveness of their mission. Long-term support should be made possible, as long as these social enterprises do not disrupt the markets in which they sometimes operate and as long as they are aimed at specific audiences.

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<sup>8</sup> See, for example, the action of the [European Microfinance Network](#).

## 2. MARKET DEFICIENCIES IN THE FINANCING OF SOCIAL ENTERPRISES IMPLY A STRUCTURAL NEED FOR STATE AIDS

As detailed above, social enterprises most of the time respond to needs not met by private initiative, due to the limited profitability of the service provided. Responding to such needs thus implies a different business and financing model from that of traditional SMEs, and therefore finding financiers or investors who do not behave like “traditional” investors or lenders. However, social enterprises face many obstacles to their financing, reflecting a market failure in this area.

In this respect, the diagnosis established by the French Chamber of Social and Solidarity Economy in its 2017 report is particularly edifying :

- Social enterprises that are seeking funding often have an unbalanced balance sheet characterized by insufficient equity or quasi-equity and do not cover their three-year funding needs well.
- The main market failures they suffer from concern :
  - the mobilization of capital at the start-up stage due to the high level of risk, with in particular a difficulty to raise amounts between €100 K and €1 M;
  - the weakness of the supply of development capital given the limited number of investment funds in this field, the modest amount of banking exposures<sup>9</sup> managed by them and the limited number of their transactions (between 5 and 15 deals per year and per fund on average), especially for large deals (€200 K to €500 K);
  - turnaround financing, for which there is no offer;
  - the absence of a secondary market for investors wishing to dispose of holdings or equity securities at the end of their investment period;<sup>10</sup>
  - access to bank financing for investment (real estate, equipment and IT) or, alternatively, to leasing for companies with little equity capital, which do not demonstrate their ability to repay thanks to operating surpluses and offer few guarantees;
  - access to bank financing of cash flow for micro-enterprises or VSEs;
  - financing for research and development or social innovation, which is very risky;<sup>11</sup>
  - as well as the financing of social support for entrepreneurs and project engineering.<sup>12</sup>

### 2.1 THE EXISTENCE OF MARKET FAILURES, AS RECOGNIZED BY THE EUROPEAN INSTITUTIONS

The existence of market failures, already recognized by the European Court of Justice (ECJ), has just been confirmed by the European Commission.

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<sup>9</sup> [The financing of Social and Solidarity-based Economy companies, French Chamber of Social and Solidarity Economy](#), March 2017, p. 179 and followings

<sup>10</sup> [The financing of Social and Solidarity-based Economy companies, French Chamber of Social and Solidarity Economy](#), March 2017, p. 175 and followings

<sup>11</sup> [The financing of Social and Solidarity-based Economy companies, French Chamber of Social and Solidarity Economy](#), March 2017, p. 131 and followings

<sup>12</sup> [The financing of Social and Solidarity-based Economy companies, French Chamber of Social and Solidarity Economy](#), March 2017, p. 139 and followings

The identification of market failures in the financing of social enterprises was first made by the ECJ in relation to cooperative companies. It noted that the fact that they are not listed on the stock exchange and do not issue negotiable shares makes access to capital markets more difficult, while the lower return on capital, due to a lower margin, makes investment in these enterprises less advantageous. Moreover, the profit margin of these companies is significantly lower than that of conventional companies, making them less adaptable to market requirements.<sup>13</sup> This led it to recognize that a scheme of exemption from corporation tax in Italy reserved for cooperatives, provided of course that the results distributed to members are taxable in their hands (recital 71) and that the tax exemption does not extend to transactions with non-member third parties (recital 72), was consistent with the Treaties. This analysis applies to all social enterprises in a similar situation (non-listing on a financial market, low return on capital due to a lower margin), which is the case for most of them.

The European Commission, in its 2016 Communication on the concept of State aid<sup>14</sup>, has taken this justification on board by accepting that this type of company can benefit from “a tax advantage not available to for-profit companies.” More recently, the Commission has attempted to assess the structural disadvantages of social enterprises. According to a study carried out by the European Center for Social Finance for the European Commission and published in 2020, the total funding gap for social enterprises in Europe is between €514 million and €1.388 billion per year. And in his intervention at the meeting of the European Commission’s Group of Experts on Social Entrepreneurship (GECES) on 29 April 2020, Commissioner Schmit, for his part, quantified this shortfall at around €1 billion per year, before the Covid-19 crisis broke out. According to the study, this recurring deficit is the result of several imperfections, which can accumulate, in the social finance market.<sup>15</sup>

The amounts of equity investment tickets are generally small and there is a deficit in the supply of small equity investment tickets. A small specialized team must, on the investor’s side, review potential investments, analyze the cases that seem most interesting and correspond to its investment strategy, negotiate the terms of its investments, if necessary by organizing a round table discussion, organize the exit conditions, follow the activity of the financed companies throughout the investment period in order to be able to support them appropriately, and monitor the industries or sectors covered by the investment strategy. It therefore seems unlikely that the funds will be able to analyze many investments with an overall financing requirement of less than €500 000.<sup>16</sup> Moreover, the rejection rate of applications is very high,<sup>17</sup> without necessarily being made public.

The social finance market also suffers from a lack of intermediaries, resulting in a low capacity to absorb capital. In this respect, the study notes a contemporary trend towards the integration of business models in order to achieve lower transaction costs. For the authors of the study, this results in a lack of intermediaries in the market. As a result, existing capital, which could be used by social enterprises, cannot always reach them because of this lack of intermediaries to manage funds and steer their investments towards social enterprises.

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<sup>13</sup> ECJ, September 8, 2011, Ministero dell’Economia e delle Finanze, Agenzia delle Entrate c./Paint Graphos, joint cases C-78/08 to 80/08, recitals 55 à 62

<sup>14</sup> [Commission Notice on the notion of State aid as referred to in Article 107\(1\) of the Treaty on the Functioning of the European Union](#) (2016), p. 30.

<sup>15</sup> ["Social enterprise finance market. Analysis and recommendations for delivery options"](#) (2020), Calculation of the financing gap based on countries participating in the EaSI programme.

<sup>16</sup> By comparison, the average ticket of intervention of *France Active* in France was €44.6 K in 2019 (being recalled that the average ticket of intervention, all phases combined, was €55 K in 2018), an amount too low to be of interest to the banks and to allow them to amortize the costs of processing the cases. *France Active* has therefore signed agreements with commercial banks which lend alongside *France Active* if the latter decides to intervene. Another valuable point of comparison drawn from the PIAESS experience (see 2.5), the average intervention ticket was €384 K for national companies but only €36 K for regional companies, the most numerous, it being recalled that 80% of the projects financed were development projects (more financially burdensome) and only 15% were creation projects. A €500 K ticket must thus be considered as very important in the social economy: it mainly concerns developing enterprises, i.e. those that have passed the five-year survival mark, have potential and a reassuring track record for funders. For example, it corresponds to the Nov’ESS fund’s minimum investment ticket for enterprises in an acceleration phase.

<sup>17</sup> In France, a medium-sized investment fund in the social economy (€20 to €30 million under management) makes an average of ten investments per year. To achieve this, it examines more than a hundred applications.

Europe is characterized by a financing that is mainly in the form of debt (see 2.4 for a confirmation of this phenomenon by Eurostat). Within the European Union, there are many more intermediaries in debt financing than in equity financing.<sup>18</sup> Several reasons can be given to explain this predominant use of debt. Business owners (especially micro-enterprises and SMEs) prefer to keep control and not be diluted, which explains their preference for debt. Secondly, borrowing does not require negotiating exit strategies and conditions during the financing phase: debt operations are therefore simpler, quicker to set up and less costly for the beneficiary. Social enterprises only need to reimburse the loan concerned according to the contractual schedule. In addition, debt financing intermediaries are also able to provide smaller loans because their business model is more standardized and an officer processing loan applications can handle more files than an officer processing an investment application for a fund. Overall, the low equity contribution relative to debt financing further disadvantages social enterprises, some of which require high equity (see point 1.2), while structurally they have little equity because they are not rated (see point 2.1), because they have no capital (see point 2.1), because the return offered is too low or because they do not have the required guarantees (see point. 2.4).

Finally, the survey points to a lack of confidence in the returns on investment. Institutional investors base their investment decisions in funds on their track record and performance. However, in an emerging field such as social finance, fund managers have little data to report. As a result, investors lack confidence in the returns they can expect from their investments in these funds, which discourages them from investing in them.

## 2.2 THE FINANCING OF SOCIAL ENTERPRISES DIFFERS FROM THAT OF FOR-PROFIT COMPANIES<sup>19</sup>

Social enterprises are not listed companies and therefore cannot have access to market financing, which is the benchmark in the market economy. It is therefore more difficult for social enterprises, when they have capital, to raise equity capital from private investors (lack of liquidity in the absence of a listing) or individuals.

Some social enterprises have no capital: this is generally the case for foundations or associations. This characteristic makes it difficult to raise equity capital to carry out economic activities.

When they do have capital, moreover, the holder of shares is often prevented from realizing financial capital gains because he or she enters and leaves at the nominal value of the share, whereas the private investor generally comes out with a financial capital gain, which remunerates the risk taken. This lack of share price appreciation, which is the rule in cooperatives and mutual but also in some social enterprises, makes access to equity capital much more difficult, especially for investors attached to capital gains and financial returns. Besides, the law frequently limits the financial return attached to the shares, by reference to the bond market rate. Also, in the event of liquidation, the net assets and the non-distributable reserves must be vested in a similar body and therefore do not revert to the shareholders. With the prospect of virtually no capital gains, a modest financial return that is capped by law and no liquidation bonus, it is understandable that the financial attractiveness of these “investments” is limited.

It was by taking into account this difference between for-profit undertakings and cooperatives that the ECJ recognized that a State aid consisting of an exemption from corporation tax for cooperatives was consistent with the Treaties.<sup>20</sup> In cooperatives and mutuals, as a matter of fact, the rule of dual status addresses this fundamental issue: to benefit from the services of the mutual or cooperative, one must join and subscribe to shares which must be kept for as long as the member wishes to benefit from the services linked to its membership and its status as a member. Outflows are usually restricted because of the non-liquidity of the investment and the closed nature of the organization (obligation to transfer to a member; approval of this member or of the transfer; transfer at nominal value; period of several months, which may even exceed one year, to complete a transfer or redemption of shares, etc.). Equity investors are therefore generally the members of the cooperative or mutual, for whom this investment is de facto compulsory in order to benefit from the services linked to membership, but through investment in equity they are looking for something other than financial profitability: the ability to obtain supplies from a central purchasing body on competitive terms (craftsmen's or traders' cooperatives; agricultural cooperatives, etc.), an ability to sell production under the best possible conditions (agricultural cooperatives, etc.), the ability to benefit

<sup>18</sup> This is also true for France, where the Banque de France noted in 2016 that bank financing of non-financial companies exceeded 80% in 2016, whereas market financing did not exceed 20%. Hence the critical nature of access to bank financing, which is not easy for social enterprises, including in France.

<sup>19</sup> A detailed description of these highly varied models can be found in [the financing of Social and Solidarity-based Economy companies, French Chamber of Social and Solidarity Economy](#), March 2017, p 110 et seq.

<sup>20</sup> ECJ, September 8, 2011, Ministero dell'Economia e delle Finanze, Agenzia delle Entrate c./Paint Graphos, joint cases C-78/08 to 80/08, recitals 55 to 62.

from services at attractive prices (insurance, banking, supplementary social protection, etc.), membership often resulting in specific discounts granted to members. The economic and financing model is therefore based on very long-term equity contributions not remunerated by the members, with, as a counterpart, the obligation to contribute an economic activity or business stream that benefits them collectively and whose management they share (democratic governance with the “one person, one vote” principle, regardless of the proportion of capital held, as in for-profit companies, since these are partnerships and not limited companies as the ECJ noted in its judgment in *Paint Graphos*, recital 56 to 58).

In addition, the financing model of these entities uses specific financial securities that are treated as quasi-equity and have no equivalent in the for-profit economy: parity and mutualist certificates, cooperative certificates, participating securities placed with members and/or, where permitted by regulations (see 2.5), investors from the social economy (provident institutions; mutual insurance companies; cooperative banks; foundations; pension funds, etc.), bonds and associational securities, etc.

In order to describe the financing model for social economy enterprises, experts refer to “hybrid” financing, i.e. financing that is not exclusively generated by sales to clients in a market.

Their income comes from several sources: income from their activities among their members (cooperatives, mutuals) or beneficiaries of their services (associations, etc.), national or local public orders, public or private subsidies (operating and/or investment); membership fees, generally without any counterpart; donations in kind (voluntary work, food aid, etc.) or in cash (donations and legacies; fund-raising for causes such as medical research, aid to the homeless, etc.); private patronage, etc. As an illustration of this difference in economic model and funding, Commissioner Schmit estimates in his online conference of 29 April 2020, with reference to a 2017 study, that there are 83 million volunteers working in these companies, equivalent to 5.5 million full-time employees, a figure to be compared with the 13.6 million employees. The resources of social enterprises are therefore much more diversified in nature than those of for-profit companies<sup>21</sup> and more uncertain. Indeed, they have to convince both private and public funders of the merits of their mission and have little say in the final decision (awarding of a public contract; granting of a subsidy; sponsorship operations; volunteer work; collection of donations; collection of contributions, etc.).

The hazard in financing, which goes hand in hand with the hybridization of resources, therefore weakens these entities much more than the lucrative private companies that draw all their financial resources from the market, on which they have a decisive influence (price positioning, marketing, communication and advertising...), and it is necessary, when possible, to invent financial products adapted to this diversity of resources. For example, specialized financial institutions in the social economy have set up cash advances on promises of subsidies that enable a social enterprise to obtain pre-financing because it is generally accepted that the payment deadlines of public authorities are generally longer than the usual duration of supplier credit to private enterprises (for the European ESF program, for example, payments can be deferred for several years). A discretionary decision to discontinue a grant is often like a death sentence for the organization that benefited from it. This solution of advancing a grant in view of a promise of a grant was then copied or taken over by the traditional banks which now offer this service to associations. But there are still no funding solutions when donations collapse as during the period of the Covid-19 health crisis, when contributions do not come in, when payments from public authorities in application of the public order are late or when a law sends a negative signal<sup>22</sup> on corporate patronage.

Lastly, the economic and financing models of social enterprises are generally not well known by for-profit banks and financial institutions, which makes it even more difficult for these enterprises to access conventional credit. This explains, on the one hand, the high rate of rejection of credit applications to private banks, and on the other hand, the fact that specialized financiers have emerged to respond to this market failure and to provide answers to its specific financing needs, if necessary by examining the files and then calling on traditional banks to complete the rounds of the table. These specialized financiers have the advantage of having a better knowledge of the economic and financing models of social enterprises, of better accommodating their particular strategic options

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<sup>21</sup> For French associations, the INSEE has broken down the structure of income in 2014 (€104 billion) as follows: 33% for income from private activities; 27% for income from public activities; 18% for public subsidies; 10% for membership fees; 4% for donations, patronage and funds received from foundations; 7% for other income. Volunteering by the 16 million volunteers is valued at €20 billion.

<sup>22</sup> For example such as the French Finance Act of 2020 (art 134) which reduces the amount of tax-deductible patronage actions for large companies by 60 to 40% above €2 million per year. The effect of this measure has been estimated by the organizations in charge of promoting patronage at a loss of €400 to 500 M per year for associations.



(primacy of social or environmental objectives) and of supporting them in setting up and structuring projects<sup>23</sup>. However, social enterprises also turn to conventional banks for needs such as cash flow or investment financing, for which they can provide guarantees.

## 2.3 INVESTORS IN SOCIAL ENTERPRISES DO NOT THINK LIKE CONVENTIONAL INVESTORS

Given the essentially social vocation of their activity, their innovative aspect, their lack of lucrative purpose or their limited lucrative nature, investors who finance social enterprises do not reason in the same way as conventional investors. For example, on the occasion of the creation of a €100 million investment fund, the Nov'ESS<sup>24</sup> fund, intended to finance social enterprises, the *Caisse des Dépôts* carried out a benchmark before posting an internal rate of return (IRR) target of 3 to 3.5% for this fund, whereas equivalent private equity funds and impact funds post or target IRRs of between 8 and 12%.<sup>25</sup>

*France Active Investissement* (FIA), the investment subsidiary of the main support network for the creation and development of solidarity enterprises, which finances social enterprises in equity and debt through solidarity finance, has posted a profitability of its investment portfolio slightly below 2% in 2018 for an average intervention ticket of €55 K (from creation to transmission). The projects are therefore selected by this investor as a priority according to social and environmental criteria, the financial profitability sought being moderate and compatible with the economic and financial model of the companies supported. As a result, legal entities that can subscribe to the capital shares alone do not receive a dividend, but the value of the share is very slightly revalued from time to time. *France Active Investissement* mentions this very clearly in its 2019 issue prospectus for institutional investors. These investors, most of whom are employee savings funds, accept this moderate return, which consists solely of a small revaluation of the employee share, because they mainly manage 90/10 funds, with investment with a social impact limited to 5% to 10% of the portfolio, the overall return on investment for the employee being mainly obtained on the listed part of the fund, under SRI management. Employee savings also benefit from a special tax regime on entry and exit (incentive for long-term investment to prepare for retirement).

Among the funds active in the field of solidarity finance and which invest in social enterprises, apart from FIA, already mentioned, we can mention the *Phitrust* fund which does not remunerate its investors and does not increase the value of the social share, the *INCO Investissement* fund, a venture capital company born in the orbit of the SOS group (cf 1. 2), which targets investment tickets in excess of €150 K and mentions an unguaranteed remuneration of between 3% and 5% per year, and the Aviva impact investing France fund, which targets investments of more than €100 K and also announces a remuneration of between 3% and 5%. In other words, the investor's financial remuneration is low or moderate and does not correspond to the risk taken. This means, among other things, that no private equity fund or business angel investor invests in social enterprises and that investors pursuing a social impact with limited financial profitability negotiate moderate entry valuations, much lower than those found in the private equity or business angel investment universe, in order to be able to provide, when the status of the enterprise does not prohibit it, a modest exit capital gain for the professional investor.<sup>26</sup>

For individual investors, the approach is similar. The study carried out by Finansol in 2014 on solidarity savers<sup>27</sup> confirms that they have a similar reasoning as patient investors when they invest directly in social enterprises or indirectly through specialized funds. On the famous "liquidity, return and risk" triptych, they accept limited liquidity with regard to unlisted securities since they remain on average 8 to 9 years in the capital of the companies in which they have invested; on the return aspect, they accept a low or zero financial return because their main wish is to

<sup>23</sup> As an illustration, the ADIE notes that 43% of the social enterprise funders applying to it for an average ticket (professional microcredit) of € 4.5 K were living below the poverty line in 2018 and that 26% have no diploma. For its part, France Active notes that 90% of the supported business funders were jobseekers and that a third of them were beneficiaries of social minima. This funder profile requires more intense support to develop a business plan and a financing plan.

<sup>24</sup> See SSE Funding - [Caisse des Dépôts launches its social and solidarity economy fund](#), 29 June 2016, *Banque des Territoires*.

<sup>25</sup> [Mapping of financing and investment offers drawn up by the Caisse des Dépôts et des financements](#).

<sup>26</sup> The moderate nature of the remuneration expected by social investors is also documented in the report of the French Committee on Socially Responsible Investment of September 2014, which follows the London G 8 of 2013, and by the preliminary work carried out by the *Caisse des Dépôts* prior to the launch of its Nov'ESS fund.

<sup>27</sup> [Solidarity savers](#) (2014), Finansol.

support projects with a high social and environmental impact; on the risk aspect, they simply wish to recover their capital at the exit. Their investment includes an assumed grant element in terms of financial return (study p. 39 and 43): “the aim is to support actions with a high social and/or environmental utility as effectively as possible.”

The risk, sometimes high, taken by individuals when investing in these companies is not counterbalanced by a promise of a strong financial return, since it is sometimes an erosion of assets that is announced, in the absence of tax incentives on entry, when there is neither a dividend nor a rise in the price of the share (see 2.2). This acceptance of a comparatively low remuneration of the sums provided represents the first form of financial solidarity. But the most important solidarity is with the people directly concerned by the offer of these companies (cf. 1.2), whether they are the populations targeted by the services developed (vulnerable populations: poor, sick, etc. or individual customers: concerned about a certain quality or a production method that respects sustainable development, etc.) or the entrepreneurs and employees of these organizations whose purpose is specific. And it is undoubtedly in relation to this object that the term “citizen finance” takes on its full meaning, since the organizations supported in this way have objects that respond to the major social (hunger, housing, health, integration, ageing, family, North-South development) and current ecological issues (agrobiodiversity, consumption and production of renewable energies, housing, mobility, water management, short circuits, etc.).

All of these investors have different objectives from those pursued by private equity investors or business angels at the pre-seed stage. They are not primarily seeking financial returns but rather to maximize the social or environmental impact of their investment. The expected financial return is therefore moderate, especially as the business models of the companies concerned bear the consequences of this fundamental choice and generate only a modest financial return.<sup>28</sup> Social impact investors, whether patient or long-term investors, have therefore integrated expectations of financial profitability in harmony with their investment inability.<sup>29</sup> As a result, the assimilation, maintained by the 2014 GBER (Article 21 of the Regulation taking up Article 29 of the previous Regulation), of investors in social enterprises with investors in private equity in SMEs in the European sense constitutes an additional handicap for the access of social enterprises to funding from these funds and no longer corresponds to the *de facto* and *de jure* state of affairs which characterizes the social economy. The Commission's definition of this type of enterprise in 2011 and 2013 and the Union (cf. 5) alone establishes that this assimilation can no longer be sustained since the main objective of this social enterprise is to have a social impact rather than to generate profit for its owners or shareholders. Moreover, the expectation of capital gains on exit is all the more limited since the SSE statutes prohibit listing on financial markets and very often prevent the realization of capital gains on exit that remunerate risk-taking. Maintaining this assimilation in the future GBER would also amount to perpetuating the difficulties of access to equity financing for these enterprises, whereas the Commission itself has insisted on the need to put in place a full range of appropriate financial instruments, which support social enterprises throughout their life cycle.

## 2.4 SOCIAL ENTERPRISES FACE MANY BARRIERS TO ACCESS TO CREDIT

While access to credit has greatly improved in the European Union since the 2008 financial crisis, thanks in particular to the quantitative easing measures adopted by the European Central Bank, it remains difficult for certain categories of businesses at certain stages of their development, or to meet certain specific needs.

However, it is difficult statistically to quantify the extent of these difficulties at the European level. Eurostat only provides statistics on access to finance for for-profit companies, but does not give any indication for social enterprises. On the realistic assumption that difficulties of access to finance are greater for not-for-profit companies, Eurostat characterizes by country the difficulties of access to finance for private companies in general. The following elements can be retained.

For equity financing, the main difficulties are the following: inability of existing shareholders to provide more equity; disadvantageous treatment of new capital providers compared to old shareholders; insufficient or too risky development resources according to the new shareholders; excessive debt; too many concessions from new shareholders. Eurostat also gives indications per country on the success rate with the main potential partners

<sup>28</sup> Unfortunately, there are very few studies on the comparative profitability of for-profit and social enterprises. In France, there is only a limited study by INSEE on non-financial cooperatives ([The financing of Social and Solidarity-based Economy companies, French Chamber of Social and Solidarity Economy](#), March 2017, p. 112 and followings).

<sup>29</sup> See in this respect [the financing of Social and Solidarity-based Economy companies, French Chamber of Social and Solidarity Economy](#), March 2017, p. 122.



(existing shareholders, directors not yet shareholders, family and friends, venture capital funds, business angels, IPOs, other companies, banks, employees of the company).

For loan financing, the main difficulties are as follows: insufficient equity capital, insufficient collateral, already too much debt, poor credit rating, insufficient potential. Eurostat also gives indications per country on the success rate with the main potential partners (family or friends, owners or directors of the enterprise, banks, other enterprises, employees of the enterprise).

The use of debt financing is four to eight times higher than the search for equity capital. In order to obtain a credit, the requirement of guarantees is mentioned in 20 to 80% of cases by the borrower and this guarantee is provided by the company or its owners in half to 90% of cases, depending on the country.

Unfortunately, European statistics do not make it possible to detail the difficulties of access to finance according to the size or nature of the company. However, national studies do make it possible to do so. Thus, *l'Observatoire du financement des entreprises* has just published a very precise inventory for France<sup>30</sup> at the end of 2019. It shows that while the financial situation of companies and their access to credit has improved, it remains difficult for VSEs: "Compared to SMEs, the overall situation of VSEs is worse. One in five VSEs has negative or zero equity capital, compared with 7% of SMEs. The proportion of VSEs considered to be in financial difficulty, i.e. presenting a deteriorated situation both in terms of equity capital and cash flow, is 14 % (250,000 VSEs out of the 1.8 million VSEs included in the analysis)" compared with less than 1 % for SMEs (report p. 26). And while the credit take-up rates for SMEs reach 90% for cash loans and 95% for investment loans, "For VSEs, these rates remain lower, especially for cash loans, for which the average acceptance rate is around 70% over the last four quarters (compared with more than 87% on average for investment loans over the same period), but the improvement is clear." As social enterprises are micro-enterprises in the European sense, and VSEs, and, for some, SMEs according to French statistics, they continue to experience significant difficulties in accessing credit despite the improvement in the general situation, mainly due to their insufficient equity and cash flow.

These difficulties are particularly sensitive for start-ups: their 5-year survival rate was 52% for those created in the early 2000's and while this rate has risen to 60% for those created in 2010, the risk of failure is still high. Despite this improvement, the financing of business creation remains a risky activity for investors, which calls for corrective measures either through public guarantee mechanisms or tax incentives. If the survival rate of social enterprises seems to be higher, this is the result of the support mechanisms specific to this sector (cf. 2.3).

An analysis dedicated solely to the social economy, the only one of such kind, conducted by the French Chamber of Social and Solidarity Economy in 2017,<sup>31</sup> confirms that social economy enterprises are VSEs and sometimes SMEs, that they encounter financing difficulties and that there are still many market failures for their financing (see 2.1). It is therefore necessary to amend the current GBER to remedy this.

## 2.5 THE EXISTENCE OF THESE MARKET FAILURES IS CONFIRMED BY A SERIES OF MEASURES TAKEN IN CERTAIN MEMBER STATES

- **Governments have put in place measures to address this market failure.**

In France, as a common factor in the financing of all companies, there is a very strong reluctance on the part of savers to invest in risky assets, i.e. in companies.<sup>32</sup> The percentage of risky assets in household assets is 3.5%, below the European average. Savers prefer to invest in government-regulated savings products (*Livret A*, etc.), in the bond market and in life insurance, the main financial product held by households, consisting mainly of bonds. To encourage savers to invest in these risky products nevertheless and to remedy this market failure, French tax law, as allowed under EU law, has introduced tax incentives for specific investment products (cinema financing, fisheries financing, financing of overseas enterprises, financing of risky innovation, financing of SMEs, including social enterprises through the *ISF-SME*, which has been abolished in 2018,<sup>33</sup> and the *IR-SME*, which is still under

<sup>30</sup> [Financing of SMEs and VSEs](#), December 2019, The Credit Mediator

<sup>31</sup> The financing of social and solidarity economy enterprises, April 2017.

<sup>32</sup> [The financing of Social and Solidarity-based Economy companies, French Chamber of Social and Solidarity Economy](#), March 2017, p. 75 and followings.

<sup>33</sup> The suppression of the FSI-SME led, for example, to a 40% drop in equity capital collected directly from individuals by socially beneficial enterprises in 2018. This spectacular decrease illustrates both the low

examination by the Commission<sup>34</sup>). This scarcity of risky savings persists despite all these measures and social enterprises are more affected than for-profit companies for the reasons indicated in the following point.

In response to this market failure, several public or private initiatives have set up specialized counters to try to remedy the financing difficulties encountered by social enterprises (all these initiatives are developed at length in the report of the French Chamber of Social and Solidarity Economy).

On the public sector side, the *Caisse des Dépôts*'s long-standing and constant action in favor of the social economy should be mentioned. It holds an investment portfolio in social enterprises in excess of €500 million, participates in the roundtable discussions of numerous funds dedicated to the social economy, and, alongside the regions, subsidizes the major networks supporting the creation of social enterprises (see 2.3). Many new initiatives have been launched in 2010: the launch in 2011, within the *Programme d'investissement avenir* (PIA), of a PIAESS with a budget of €100 M, whose activity ceased in 2016, the attribution by law in 2012 to the *Banque publique d'investissement* (bpi) of a specific mission of financing the SSE, which it fulfilled in a very disappointing way due to its lack of knowledge of this sector and its actors,<sup>35</sup> the creation in 2013 of a social innovation fund (FISO) endowed with €20 M, equally divided between the State and the regions and whose management, with controversial results, has been entrusted to the bpi and, in 2015, the creation of an investment fund, *Impact coopératif*, dedicated to the financing of cooperatives. At the same time, the public authorities have encouraged the development of solidarity finance by making it compulsory as of 2010 to present a solidarity offer within employee savings funds (the famous 90/10 funds, of which 5 to 10% are invested in companies approved by the public authorities as being of social utility). Over the years, the managers of these funds have become significant investors in social enterprises (cumulative assets under management reached nearly €1 Bn at the end of 2019).<sup>36</sup>

Public authorities have also set up effective guarantee or mutual guarantee mechanisms to limit the risk of investors in the social economy, for which the EIF and the EIB have also been called upon. Unfortunately, following the almost complete debugging of these credits when France was placed under the European Union's supervisory mechanism, the level of guarantees, assumed by the bpi on its financial results, has been significantly downgraded. Beyond this observation, the prudential treatment of guarantees by the Basel Committee continues to penalize the social enterprises for which they are structurally necessary, in addition to the regulatory obstacles listed below.<sup>37</sup>

As regards banks that belong to the social economy, we can note the creation of IDES in 1983, with the support of the State, which for a long time remained the sole provider of equity capital for the SSE, and more recently the support for the emergence of participative financing platforms oriented towards the social economy. Private banks have also signed agreements with the major support and financing networks for the creation and development of social enterprises (ADIE, *France Active*, *Initiative France*).

Many institutional investors (insurance companies, provident institutions, complementary pension funds, etc.) have also contributed to the creation of investment funds specialized in the social economy or targeted at social enterprises (*Investir & +*, *Phitrust*, etc.).

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appetite of individual savers for risky investments in the absence of tax incentives for investment, the precarious access of these companies to equity capital and the lack of predictability of their financing for economic operators due to the tax instability that is denounced everywhere.

<sup>34</sup> **[NB:** The scheme has been approved by the Commission since the initial redaction and submission of this memorandum to the EC.]

<sup>35</sup> [The financing of Social and Solidarity-based Economy companies, French Chamber of Social and Solidarity Economy](#), March 2017, p. 87 and followings.

<sup>36</sup> It should be noted, however, that the management horizon of these funds is limited, since by law employees can exit from employee savings funds after five years, and organizing the exit of capital from unlisted companies at such a short notice remains problematic. Moreover, since these funds are managed on a fiduciary basis on behalf of third parties (employees), managers cannot take risks and thus avoid financing seed capital in order to concentrate investments on established players of significant size.

<sup>37</sup> On all these points, see [the financing of Social and Solidarity-based Economy companies, French Chamber of Social and Solidarity Economy](#), March 2017, p. 149 and followings.

- **All these initiatives have made it possible to set up an ecosystem favorable to the development of social enterprises,<sup>38</sup> but market failures in access to funding for social economy enterprises have not disappeared, in particular because funding for social economy enterprises does not occupy a sufficient place in the hierarchy of public priorities.<sup>39</sup>**

Despite the measures taken by some Member States to address these market failures, regulatory barriers to access to equity capital still remain. French and European legislators want to protect savers by guaranteeing them the advantage of the liquidity of their investment, whereas savers investing in social finance are patient long-term investors.<sup>40</sup>

### Examples of regulatory obstacles in France :

Article R. 332-2 of the *code des assurances*, which governs investments authorized to insurance companies, includes some of the specific securities of the social economy assimilated to quasi-equity<sup>41</sup> but none of the securities representing equity capital are listed.

Similarly, Article R. 930-10-21 of the *code de la sécurité sociale* governs investments authorized to other institutional investors (pension funds, provident institutions, mutual insurance companies, foundations and endowments, etc.<sup>42</sup>) by holding roughly identical quasi-equity securities.<sup>43</sup> It also favors securities issued by OECD countries and public authorities as well as commercial companies, but excludes many unlisted securities from the social economy. As we have seen, since the latter is based exclusively on unlisted securities, the legislation, by giving disproportionate importance to the requirement for liquidity of investments, introduces structural discrimination to the detriment of an entire sector of the economy, especially since the investors and savers concerned do not demand this instant liquidity at all times. Member shares giving access to equity capital cannot therefore be included in the portfolios of institutional investors, nor can many securities giving access to quasi-equity either, notably all those issued by associations representing 93% of employers in the social economy (see note 3). As an illustration of this phenomenon of excessive protection of savers in spite of themselves and a marked distrust of the boards of directors and specialized committees of these investors, Decree No. 2017-887 of 9 May 2017 on the financial organization of certain social security schemes, issued

<sup>38</sup> [The financing of Social and Solidarity-based Economy enterprises, French Chamber of Social and Solidarity Economy](#), March 2017, p. 175 and followings.

<sup>39</sup> [The financing of Social and Solidarity-based Economy enterprises, French Chamber of Social and Solidarity Economy](#), March 2017, p. 184

<sup>40</sup> According to studies conducted by Finansol, solidarity savers keep their investments for an average of 8 to 9 years. Employee savings are blocked for 5 years; tax benefits on entry are also linked to a minimum holding period of 5 years; except in rare cases of early unblocking, funds invested in retirement savings products are blocked until retirement age.

<sup>41</sup> For example, "Participating securities" are mentioned under A 2° c) and "Bonds, participating securities, mutualist certificates, where applicable joint certificates, and subordinated securities issued by mutual insurance companies, mutual societies, unions and federations governed by the *code de la mutualité* and provident institutions governed by Title III of Book IX of the Social Security Code having their registered office in the territory of one of the Member States of the OECD" are mentioned under A 7) c).

<sup>42</sup> In a March 2016 information report on the implementation of the July 31, 2014 law on the social economy, parliamentarians had asked the government to amend this article to allow foundations to invest in securities issued by social economy enterprises, including those incorporated in commercial form ([The financing of Social and Solidarity-based Economy enterprises, French Chamber of Social and Solidarity Economy](#), March 2017, p. 177 et seq.) This wish naturally fell on deaf ears.

<sup>43</sup> Thus, under A 8°, after "Shares, units and rights issued by commercial companies", we find "bonds, participating securities and subordinated securities issued by mutual insurance companies, provident institutions or unions of a provident institution and mutual insurance companies, unions and federations governed by the *code de la mutualité*, having their registered office on the territory of one of the OECD Member States, other than the values referred to in 2°, 3°, 3° bis, 4°, 5°, 6°, 7°, 9° bis, 10° and 12°". The comparison with the similar article of the *code des assurances* mentioned above is interesting because it excludes mutual and paritarian certificates, without any apparent reason.

after a series of reports by the General Inspectorate of Social Affairs,<sup>44</sup> restricted the investment capacities of these funds by amending Articles R. 623-10-5 et seq. of the *code de la sécurité sociale*. By simplifying all securities issued by the social economy, all securities issued by the social economy are eliminated from the investments permitted to these funds, except for certain equity securities,<sup>45</sup> since Articles R.623-10-10 and R.623-10-11<sup>46</sup> require that the securities eligible for investment by the funds be listed on a regulated market.

The inspiration of all these texts contradicts the meaning of history: most institutional investors have spearheaded the development of SRI for listed securities and some show a growing appetite for impact investing and green finance. The current regulation hinders this appetite and contradicts the European guidelines encouraging sustainable development. In any case, it leaves the social economy practically outside the scope of authorized investments, thereby increasing the difficulties of access to financing for this sector.

**Other examples of government-imposed regulatory barriers to access to credit for social economy enterprises can illustrate the permanence and regular reiteration of these barriers.**

Firstly, the Amending Finance Act No. 2013-1279 of December 29, 2013 initiated a reform of the life insurance sector to improve the contribution of life insurance outstandings (€1,500 Bn at the time, which became €1,750 Bn in mid-2019) to the financing of the economy (see above). This reorientation was to be achieved through two levers: the “euro-growth” contract and the “life-generation” contract, the latter offering a reduction in inheritance tax as soon as 33% of the deposits were invested in SMEs/FBIs, social housing or solidarity assets. However, the Decree relating to the transfer of the “life-generation” contract to solidarity assets had been forgotten by the government, which had the effect of excluding solidarity assets from this new contract when it was launched commercially. This Decree No; 2016-918 of July 4, 2016, which contains less than 10 useful lines, was published two years late, after a consultation of the Higher Council for the Social and Solidarity Economy that took place on December 4, 2015! As a result, the networks of banks and insurance companies did not propose to savers to subscribe to these solidarity assets, even though they are the main financial investment of households.

Secondly, in response to a request from Finansol, the French Parliament, in Article 80 of Law No. 2016-1691 of December 9, 2016 on transparency, the fight against corruption and the modernization of economic life, known as the “Sapin II” law, transformed the sustainable development savings account (LDD) into a sustainable and solidarity-based development savings account (LDDS), by providing for a dual solidarity-based financing mechanism based on the resources collected in this account and not centralized at the *Caisse des Dépôts*. On the one hand, the holder can give all or part of the interest or capital proceeds to a beneficiary of his or her choice belonging to the social economy, according to a so-called “sharing” mechanism, chosen from a list drawn up by the holder of the passbook. On the other hand, the credit institutions managing these passbook accounts must finance, from resources not centralized at the *Caisse des Dépôts* (i.e. about 40% of the funds collected in this savings account estimated at €114 Bn at the beginning of 2020), in addition to the energy renovation of buildings and SMEs, legal entities belonging to the social economy. All of these provisions, codified in Articles L. 221-27 and L. 221-5 of the *code monétaire et financier*, have so far not been able to come into force due to the obstruction put in place by the Government since the beginning of 2017 to publish the decrees necessary for their application. It was only after repeated complaints from the French Chamber of Social and Solidarity Economy (ESS France) and Finansol and the threat of an appeal to the *Conseil d'Etat* that the Government finally resolved, after three years of deadlock, to publish the first of these implementing texts on December 6, 2019, the Decree of December 4, 2019, which specifies the terms and conditions for allocating the sums deposited in the sustainable and solidarity development savings account as a donation. But, against all

<sup>44</sup> June 2013 reports on 6 mandatory pension schemes such as the report RM2012-129P on the autonomous pension fund for French doctors, available on the following link <http://www.igas.gouv.fr/IMG/pdf/RM2012-129P.pdf>

<sup>45</sup> Article. R. 623-10-9. provides that “-The assets referred to in 1° and 4° of Article R. 623-10-8 may only consist of: ...6° Equity securities falling within the scope of Section 4 of Chapter III of Title I of Book II of the *code monétaire et financier*,”. Article L. 213-32 of the *code monétaire et financier* limits the eligible participating securities to those issued by “Public-sector joint-stock companies, PLC cooperatives, coordinating companies within the meaning of Article L. 423-1-1 of the *code de la construction et de l’habitation*, and the public housing offices mentioned in Article L. 411-2 of the same code, public limited companies for low-rent housing mentioned in Article L. 422-2 of the said code, mutual or cooperative banks and public State industrial and commercial establishments”, to which Articles L. 213-33 and L. 213-34 add insurance companies and agricultural cooperative societies and their unions for issues made in accordance with Article L. 523-8 of the *code rural et de la pêche maritime*.

<sup>46</sup> This article states that “Eligible financial securities meet the following conditions: ...3° They are negotiable.”

expectations, this Decree has notably added, compared to the one that gave rise to the consultation of the Higher Council of Social and Solidarity Economy at the end of December 2016, a deferred entry into force on June 1st, 2020, which will illegally deprive for six more months savers, who have already been prevented from doing so for three years, of the faculty to make donations from their LDDS<sup>47</sup>. In addition, and above all, the Government has continued to block the admission of the decree to the *Conseil d'Etat*, which is necessary for the application of Article L.221-5 of the *code monétaire et financier*, the most important for the social and solidarity economy which should have benefited since 2017, without this blockage, from additional funding of around €100 million per year, from the resources deposited in these savings account. Under these conditions, the French Chamber of Social and Solidarity Economy and Finansol, which sent the Prime Minister and the Minister of Economy and Finance a preliminary appeal in early November 2019, referred the matter to the *Conseil d'Etat* on February 4, 2020, so that it could enjoin the latter to adopt, more than three years after the publication of the Sapin II law, all the texts necessary for the application of its Article 80, while respecting its objectives and means. In the meantime, the social economy has been deprived of access to the bank credit granted from this resource, while for-profit SMEs benefit from 85% of the credits granted from it.

Thus, in a certain number of cases, in spite of a favorable vote by Parliament on the occasion of major reforms in favor of the social economy, the Executive can, without the knowledge of the elected representatives of the nation and public opinion, block the application of these measures, leaving social enterprises out of the progress hoped for and announced, and condemning them to patience and guerrilla warfare against certain ministries, especially the Ministry in charge of the economy and finance.

Among the difficulties encountered in accessing bank credit is also the fact that few social companies have a *Banque de France* rating out of the 270,000 monitored by the central bank. However, this rating, especially the credit rating, is fundamental to facilitate this access. Moreover, despite the efforts already made by the central bank, the specific characteristics of these companies in terms of the composition of their turnover, the structure of their balance sheet and their profitability still need to be better taken into account so that they are not rated as having a higher risk profile than for-profit companies.

### 3. THE INADEQUACY OF THE CURRENT REGIME FOR SOCIAL ENTERPRISES

#### 3.1 THE REASONS FOR THE APPLICATION OF ARTICLE 107 TO SOCIAL ENTERPRISES

Social enterprises are subject to Article 107 TFEU due to their qualification as an undertaking within the meaning of European law. Under competition law, any entity carrying out an economic activity is in fact considered as an undertaking, regardless of its legal status or the way it is financed.<sup>48</sup> More generally, under Article 54 TFEU on the freedom of establishment, EU law recognizes two types of entities: on the one hand, not-for-profit entities, which cover exclusively organizations with an economically disinterested activity; on the other hand, undertakings, which mainly include commercial and civil companies.

However, these definitions do not take into account the specificity of social enterprises, which are therefore covered by the common system of undertakings.

Social enterprises, although they carry out an economic activity, differ from these traditional companies, hence the inadequacy of the GBER for such entities. They differ according to a number of criteria: their main purpose, which is to maximize the social or environmental impact of their activity by allowing a limited financial return, their constraints in terms of compulsory reinvestment of most of their profits and the limitation of their residual capacity

<sup>47</sup> These donations were intended in particular to contribute to the financing of social enterprise creators by the major support networks of the social economy, which have been seen to be underfunded (see 2.3).

<sup>48</sup> Settled case law of the Court of Justice of the European Union since the *Höfner and Elser v. Macrotron* judgment, Case C-41/90, 23 April 1991.



for distribution to shareholders, and their governance, and the shortcomings they encounter in access to finance (see 2).

It is therefore essential to identify in the future GBER a new category between undertakings and not-for-profit entities: that of social enterprises, whose differentiation from the two existing categories has been explained above. To do this, it is possible to cling to an existing definition, that given by the EuSEF Regulation of 2013 (see 4.1.2).

This is all the more necessary since aid to SEs cannot escape State aid control by virtue of the fact that it would not affect trade between Member States. Indeed, although the activity of SEs is essentially national (with few exports), it cannot be ruled out that it affects trade between Member States because of the particularly broad nature of this concept. It is therefore essential to mitigate the application of the State aid regime to – *in fine* – SEs.

### 3.2 THE UNSUITABILITY OF THE INDIVIDUAL NOTIFICATION PROCEDURE FOR SOCIAL ENTERPRISES

The individual notification procedure is unsuitable for social enterprises for the following reasons.

Firstly, such notifications would in practice be difficult for governments to implement because the amount of aid granted to social enterprises cannot be determined in advance. Indeed, in the case of tax aid for instance, the aid is indirect, and many investors, particularly private individuals, do not apply for aid once their investment in a social enterprise has been made.

Secondly, while the responsibility for notification lies with the Member State concerned, the fact remains that the main beneficiaries are involved to a significant extent in this procedure. However, social enterprises, because of their size (cf. introduction), do not generally have the internal human resources necessary to ensure this administrative burden, which is considerable.

The number of notifications to be filed would be very high given the modest amount of the average investment ticket for investment funds (cf. 2.3), the much lower amount for subscriptions to the capital of solidarity enterprises by individual investors,<sup>49</sup> and the growing number of social enterprises created.

Last but not least, the difficulties mentioned above in accessing finance are structural difficulties affecting all SE and, symmetrically, they must be addressed in a structural and sustainable way. Forcing SE to obtain individual notification of the aid from which they indirectly benefit amounts to imposing on them a certain legal uncertainty as to the treatment of the measure concerned. On the contrary, obtaining a targeted amendment of the GBER would provide them with almost perfect legal certainty and would therefore ideally meet their needs.

It is therefore desirable to deal with the case of social enterprises in the future GBER because the individual notification procedure is not appropriate for them in the event that they receive State aid. Dealing with the case of such undertakings in the general regulation would avoid all these difficulties.

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<sup>49</sup> In its 2014 study on solidarity savers (p 88), Finansol established that the average investment stock held in France by an individual in 2012 was €3,449 for direct subscription to the capital of social enterprises, that this stock was €11,510 in the banking circuit and less than €3,485 for solidarity employee savings. The amounts subscribed annually are also capped, for all reasons, at €10,000 per year and per household for tax purposes (income tax deductions). For the stock of subscriptions to the capital of solidarity enterprises, the median amount invested was €91 in 2012, with 51% of solidarity savers having invested less than €100, especially among those under 40 (p 53). In 2018, there were around 120,000 individual direct shareholders in these companies. In terms of annual flows, the amounts are more modest. For solidarity employee savings, the median amount invested was €1,150 in 2012, with 55% having invested less than €1,000 in these products (p 74). This channel accounted for 80% of new subscriptions in 2012 (p 74), i.e. around 800,000 people out of the one million holders of solidarity products (p 24).

### 3.3 THE UNSUITABILITY OF THE GBER FOR SOCIAL ENTERPRISES

As the GBER does not recognise SE as such, they are by default subject to the classical SME regime for the determination of the conditions for exemption.

Indeed, in its organization (the department in charge of social economy has long belonged to DG Enterprise and was attached to SMEs) and in the 2008 and 2014 GBER, the Commission has assimilated social enterprises to SMEs whereas they are micro-enterprises (see introduction). However, this assimilation of social enterprises to SMEs in the European sense is no longer possible today given what is known about their size, their predominantly social activities (cf. 1.1) and their specific financing models, which totally differentiate them from for-profit companies, in addition to their governance.

However, to date, aid for SEs still has to comply with the criteria of Article 21 of the GBER (and the future Article 56). According to this article, the aid from which social enterprises can benefit because of their SME status is limited (i) to enterprises with less than 7 years of seniority and (ii) to a total amount of €15 M.

However, these two limitations are inadequate for social enterprises.

#### 3.3.1 The seniority condition of less than 7 years is not adapted to the specificities of social enterprises

In the case of SMEs, which are distinct from social enterprises (cf. 1), the time limit is justified because it is an aid for the launch of the enterprise active on a market where it could harm fair competition by benefiting from State aid without any time limit: indeed, after a certain period of time, the SME is supposed to have “proved its worth” on the market: either it maintains itself because it meets a demand, or it does not and there is no reason to maintain it artificially. On the other hand, most social enterprises are more than 7 years old and the aid is not justified by their start of activity but by the structural and perennial market failures they face for access to financing (cf 2), as recognized by the ECJ and the Commission.

Thus, if the 7-year limit provided by the GBER to support SMEs is justified for traditional SMEs that can access the capital markets, it is not adapted to social enterprises and is not consistent with the case law of the Court.<sup>50</sup> Indeed, for the latter, the non-listing (which is the rule in the social economy) constitutes a permanent difficulty, which can be qualified as structural, in the access to risk capital, and which does not cease 7 years after the creation of the enterprise (cf. 2).

Social enterprises face difficulties to finance themselves throughout their life due to their social objective and their lack of a market quotation (cf. 2.2). The more successful they are, the more they have to raise funds to meet a social inclusion mission that extends geographically from the local to the regional level and then to the national or sectoral level with the success they have achieved (cf. 1.2 on the SOS group’s journey). By way of illustration, the difficulty of providing attractive compensation for the risk to be financed remains valid throughout their lifespan. They must therefore be able to benefit from support for their development over their entire life cycle, in particular support to raise the equity capital needed to pursue their social objective over the long term

#### 3.3.2 Limiting the amount of aid to €15 million is also not appropriate for social enterprises

This cap is indeed too low for many of them, especially those operating in capital-intensive sectors. This is, for example, the case in renewable energy production, a sector in which social enterprises operate based on local citizen initiatives with investment financed by a multitude of individual investors, most of whom become consumers of the energy produced (according to a model close to the cooperative model, cf. 1.2). This is still the case in the sectors of social housing and accommodation for the homeless or the installation of young farmers in sustainable or organic agriculture (cf. 1.2) for which the purchase of housing or agricultural land and its provision to vulnerable groups requires significant equity capital. For example, the current limit on risk-financing aid is currently an obstacle to raising sufficient funds in relation to the intrinsic needs of their activity, whereas a more effective fight against exclusion would imply mobilizing more funds to address market failures.

<sup>50</sup> ECJ, 8 September 2011, Ministero dell’Economia e delle Finanze, Agenzia delle Entrate c./Paint Graphos, joint cases C-78/08 to 80/08.



Thus, as for the temporal limitation, the need for support for social enterprises is not cyclical but structural, if we follow the analysis made by the ECJ (cf. 2.1) and by the Commission itself on the structural nature of the market failures in access to funding for social enterprises, whose first characteristic is to not be listed entities.

Consequently, it is not appropriate to apply a cap for the entire life of a social enterprise, when, moreover, its influence on the market is marginal given its size and the underprivileged groups it serves (cf. 1.2).

## 4. AMENDMENTS TO THE GBER NECESSARY TO ADAPT THE SYSTEM OF STATE AID TO SOCIAL ENTERPRISES

### 4.1 THE INTRODUCTION OF A DEFINITION OF SOCIAL ENTERPRISES IN THE GBER

The above developments on the role of social enterprises in the fight against social exclusion, which is one of the pillars of the European Union's social policy, requires their introduction for the first time in the GBER in order to sustain their action and to stabilize their particular financing model (cf 2.2), now clearly distinguishing them from private SMEs to which they should not be assimilated for the reasons explained at length above.

The Union has already carried out a number of studies in this area, which should be briefly recalled before proposing to adopt the stabilized and highly operational definition it has arrived at.

#### 4.1.1 Recent European work has led to a definition of the social enterprise

The social economy has enjoyed growing political recognition since the beginning of the 1990s. Under the impetus of Michel Barnier, the EU has started to take a more serious interest in the social economy and social enterprises. An "Social Business Initiative – Creating a favourable climate for social enterprises, key stakeholders in the social economy and innovation"<sup>51</sup> was formalized in a European Commission Communication of 25 October 2011.

In line with this, Regulation No. 346/2013 of the Parliament and of the Council of 17 April 2013 on European Social Entrepreneurship Funds sets out a common framework for eligible social entrepreneurship funds (EuSEFs). It also defines (recital 12) the social enterprise "*an operator in the social economy, the main objective of which is to have a social impact rather than to make a profit for its owners or shareholders. It operates by providing goods and services for the market and uses its profits primarily to achieve social objectives [...]*". Shortly afterwards, Regulation No. 1296/2013 of 11 December 2013<sup>52</sup> on the EaSI programme defines (Article 2) the social enterprise according to the same criteria: the objective of producing positive social effects, the use of profits primarily to serve its main purpose and responsible and transparent management. These two regulations have therefore allowed a concrete implementation of the principles set out in the 2011 Communication in the two areas they cover. This incorporation of the definition of social enterprise in EU legislation does not mean that it is generally binding in national legislation: it applies only to the areas covered by the texts incorporating it.

The Council of the European Union also endorsed this definition in its Council Conclusions of 7 December 2015 (Recital 9) on "*The promotion of the social economy as a key driver of economic and social development in Europe.*"<sup>53</sup>

Finally, opinions of the European Parliament and the ESEC (including the above-mentioned opinion of 19 June 2019) have made recommendations for the development of the social economy based on the definition of social enterprise. The European Parliament, in a resolution of 2018 on the "Statute for social and solidarity-based

<sup>51</sup> [Social Business Initiative](#), 2011, European Commission.

<sup>52</sup> [Regulation n°1296/2013 establishing a European Progress Microfinance Facility for employment and social inclusion](#)

<sup>53</sup> [The promotion of the social economy as a key driver of economic and social development in Europe](#) - Council Conclusions (7 December 2015).

enterprises,”<sup>54</sup> “[c]onsiders that social and solidarity-based enterprises bearing the European Social Economy Label should be recognised as such in all Member States, according to the types of activity in which they engage, and should enjoy the same benefits, rights and obligations as enterprises incorporated under the law of the Member State in which they operate” (§13) and ; “[e]mphasises the need to support social and solidarity-based enterprises by providing them with sufficient funding, as financial sustainability is vital to their survival; highlights the need to foster financial support offered by private investors and public entities to social and solidarity-based enterprises at regional, national and Union level” (§33).

All in all, this work conducted by various European institutions has made it possible to identify, in a convergent manner, the structuring and consensual criteria defining social enterprises in Europe.

#### 4.1.2 The most consensual and successful definition of a social enterprise was given by Article 3(d) of Regulation 346/2013 on European social entrepreneurship funds

It is this definition that is suggested to be included in the GBER or to which the GBER could refer. The definition is as follows:

*“(...) an undertaking that:*

*(i) at the time of an investment by the qualifying social entrepreneurship fund is not admitted to trading on a regulated market or on a multilateral trading facility (MTF) as defined in point (14) and point (15) of Article 4(1) of Directive 2004/39/EC;*

*(ii) has the achievement of measurable, positive social impacts as its primary objective in accordance with its articles of association, statutes or any other rules or instruments of incorporation establishing the business, where the undertaking:*

- *provides services or goods to vulnerable or marginalized, disadvantaged or excluded persons,*
- *employs a method of production of goods or services that embodies its social objective, or*
- *provides financial support exclusively to social undertakings as defined in the first two indents;*

*(iii) uses its profits primarily to achieve its primary social objective in accordance with its articles of association, statutes or any other rules or instruments of incorporation establishing the business and with the predefined procedures and rules therein, which determine the circumstances in which profits are distributed to shareholders and owners to ensure that any such distribution of profits does not undermine its primary objective;*

*(iv) is managed in an accountable and transparent way, in particular by involving workers, customers and stakeholders affected by its business activities;*

*(v) is established within the territory of a Member State, or in a third country provided that the third country:*

- *is not listed as a Non-Cooperative Country and Territory by the Financial Action Task Force on Anti-Money Laundering and Terrorist Financing,*
- *has signed an agreement with the home Member State of the manager of a qualifying social entrepreneurship fund and with each other Member State in which the units or shares of the qualifying social entrepreneurship fund are intended to be marketed to ensure that the third country fully complies with the standards laid down in Article 26 of the OECD Model Tax Convention on Income and on Capital and ensures an effective exchange of information in tax matters, including any multilateral tax agreements; [...]*

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<sup>54</sup> [European Parliament resolution](#) of 5 July 2018 with recommendations to the Commission on a Statute for social and solidarity-based enterprises, 2018

This definition presents many merits:

- by highlighting the unlisted nature of these enterprises, it corresponds to the analysis of the ECJ and the Commission, which, for this reason, recognizes a market failure for the financing of social enterprises (cf. 2.1)
- by emphasizing the preponderance of positive and measurable social or environmental impact over financial profitability, it also justifies that financing is more difficult to find for these enterprises with modest financial profitability (cf. 2.2) and makes it possible to clearly differentiate them from private for-profit companies insofar as the possible distribution of profits to shareholders, where there are any, must not undermine these overriding objectives (limited profitability or obligation to reinvest the majority of profits in the project);
- by describing the public targeted by these undertakings as “*vulnerable, marginalized, disadvantaged or excluded persons*”, it seeks to remedy the shortcomings of the markets in which these undertakings operate (see 1.2) and confines the activity of these undertakings to market segments which are not of interest to private for-profit undertakings and thus limits *a priori* the disruption which these undertakings could cause to the functioning of the markets if they received State aid;
- by imposing democratic governance involving all stakeholders, including staff and customers, they ensure that the company’s activity and working methods are effectively geared to meeting the social inclusion needs of the target groups;
- it has been carefully drafted so that it can be applied throughout the Union;<sup>55</sup> moreover, it covers all the characteristics noted in the first part of this argument.

This definition can therefore be used to provide a clear framework for the general exemption for social enterprises and to prevent the granting of State aid, whether permanent or long-term, from disturbing the proper functioning of the markets. Furthermore, following the example of the EuSEF and EaSI regulations, the adoption of this definition in the framework of the GBER does not result in a definition that is generally binding on Member States in other areas, while continuing to respect the diversity of situations across the European Union.

## 4.2 ADAPTING THE LIMITATIONS TO EXEMPTION

### 4.2.1 **For the above reasons (see point 3), it is consistent and necessary to abolish the limit of 7 years on the maximum seniority for a social enterprise, which is not an SME, to be eligible for State aid.**

In order to address the structural market failures which hamper their access to finance, SE, provided that they meet the criteria of the definition mentioned above, must be able to benefit from aid throughout their activity and independently of a start-up period.

### 4.2.2 **As far as the amount of aid is concerned, it is also consistent to abolish, for the above reasons (see point 3), the limitation of the cap on aid.**

If the Commission were to find it impossible to abolish the cap, it would in any case have to be significantly higher than the cap for SMEs, which are in a much more favorable position as regards access to finance.

Account would also have to be taken of the specific financing needs of sectors where a high level of equity capital is required (cf. 1.2), with the difficulty of pinpointing them precisely without making unjustified exclusions.

This radical solution does not, however, leave the Commission powerless, since it could, on the occasion of the periodic review of the GBER, decide to reinstate one if the conditions of access to finance for social enterprises were to improve to such an extent that they would become similar to those enjoyed by enterprises.

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<sup>55</sup> See in particular Annex 2 of the [European Commission's Comparative Synthesis Report](#) on Social Enterprises and their Ecosystems in Europe, 2020, European Commission.

## 5. THE PROPOSED CHANGES ARE IN LINE WITH THE SPIRIT OF THE GBER AND THE EUROPEAN INITIATIVES FOR THE SOCIAL ENTERPRISE

The incorporation of these new definition and exemption does not imply a fundamental change to the GBER but simply to take account of a factual and legal situation which could not be adequately addressed when the GBER was drafted in 2014, given the very recent incorporation of the definition of social enterprise into Union law at that time.

### 5.1 THE PROPOSED AMENDMENTS ARE IN LINE WITH THE SPIRIT OF THE CURRENT GBER

In the first recital of the GBER, the Commission recalled the evolutive nature of this Regulation and its scope in the following terms :

*“Provided that sufficient case experience is further developed allowing the design of operational exemption criteria ensuring the ex-ante compatibility of other categories of aid, the Commission intends to review the scope of this Regulation with a view to including certain types of aid in those areas.”*

In recital 42, the Commission also acknowledges that there are differences between SMEs which justify different treatment :

*“Having regard to the specific handicaps and differences between SMEs, different basic aid intensities and different bonuses may apply.”*

The considerations developed in the first part justify that micro-enterprises, which are social enterprises, should cease to be assimilated to SMEs and that, in view of their characteristics, they should be treated more favourably than SMEs insofar as their financing difficulties are structural and much greater than those encountered by SMEs.

Finally, the Commission recognizes in recital 43 the shortcomings of the risk capital market in the Union for certain types of investment made at different stages of company development. This recognition by the Commission of market failures for risk capital applies *a fortiori* to social enterprises, the first part of which has amply demonstrated that they face specific, much broader and more significant difficulties of access to finance.

### 5.2 THE PROPOSED AMENDMENTS ARE IN LINE WITH THE EUROPEAN INITIATIVES PROMOTING THE SOCIAL ENTERPRISE

#### 5.2.1 The proposed definition is in line with recent European initiatives

The proposed definition is in line with the various definitions of social enterprise proposed in particular by (i) Michel Barnier in the framework of the Social Business Initiative launched in 2011, (ii) Regulation No. 346/2013 on the European social entrepreneurship funds (Article 3), (iii) Regulation No. 1296/2013 of 11 December 2013<sup>56</sup> on the EaSI programme (Article 2), (iv) the European Parliament’s own-initiative report of 2016, and (v) the EESC opinion of 19 June 2019 “Towards an appropriate European legal framework for social economy enterprises” (see introduction).

In particular, the EESC opinion convincingly argues for a rational evolution of the European legal system in order to recognize the reality of the social enterprise, halfway between the for-profit enterprise and the disinterested entity, as a third category of economic actors whose profitability is deliberately limited by the priority given to other purposes.<sup>57</sup>

<sup>56</sup> [Regulation No. 1296/2013 establishing a European Progress Microfinance Facility for employment and social inclusion](#) (EaSI).

<sup>57</sup> Cf. EESC opinion, A. Coheur, “Towards an appropriate European legal framework for social economy enterprises”, 19 June 2019, 2.2.15.

It should also be recalled that the European Union has already admitted to reserve a more favorable treatment to social enterprises in terms of access to public procurement, whose weight has been seen in their “hybrid” resources (cf. 2.2), which is however the field by excellence where European and national law make the principle of free or equal access to public procurement between economic operators prevail (see recital 14 of the Directive mentioned hereafter for their broad definition and its Article 18 on the reminder of equal access to this procurement). Indeed, Directive 2014/24/EU provides that Member States may provide that public purchasers reserve certain contracts for specific undertakings adapted or those companies that integrate by economic activity employing handicapped or disadvantaged persons (Article 20) or for certain organizations for public contracts relating exclusively to the health, social or cultural services referred to in Article 74 and mentioned in Annex XIV and introduce social or environmental criteria for selecting the successful tenderers (Article 67), commonly referred to as “social clauses”. The justification for a reservation to specific and social enterprises is contained in recital 36<sup>58</sup> while recitals 97 and 99 justify the introduction of social or environmental criteria in the criteria for the award or performance of contracts by interesting developments.<sup>59</sup> As these measures are left to the discretion of the Member States, social enterprises do not benefit from them or benefit little from them if they remain largely unimplemented by the public authorities of the Member State concerned.<sup>60</sup>

But in legal terms, it is undeniable that social enterprises can benefit from more favorable treatment in terms of access to public procurement, which is one of the modalities of their specific financing; reserving them a more favorable treatment in terms of access to other financing modalities therefore no longer poses a legal problem provided that these specific financing difficulties are demonstrated, which is the case, and that the remedies proposed remain proportionate.

## 5.2.2 The proposed amendment to the GBER is in line with current EU strategic objectives

The European Commission, under the presidency of Ursula von der Leyen, wants to intensify the development of the European social economy. The mission letter sent by the President to the Commissioner for Jobs and Social Rights, Nicolas Schmit, mandates him to present a European Action Plan for the Social Economy and Social Enterprises in 2021. This plan is intended to address the specific difficulties and needs of social economy enterprises.

The proposed amendment to the GBER will contribute to the success of this plan since it will help to partially resolve the financing difficulties encountered by social enterprises.

Moreover, these modifications are perfectly aligned with the objectives of the InvestEU Fund, i.e. :

- Contributing to the achievement of, inter alia, the EU's social inclusion objectives ;
- Investments in small and medium-sized enterprises (SMEs) and mid-sized enterprises, as well as social and skills investments;

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<sup>58</sup> “Employment and occupation contribute to integration in society and are key elements in guaranteeing equal opportunities for all. In this context, sheltered workshops can play a significant role. The same is true for other social businesses whose main aim is to support the social and professional integration or reintegration of disabled and disadvantaged persons, such as the unemployed, members of disadvantaged minorities or otherwise socially marginalized groups. However, such workshops or businesses might not be able to obtain contracts under normal conditions of competition. Consequently, it is appropriate to provide that Member States should be able to reserve the right to participate in award procedures for public contracts or for certain lots thereof to such workshops or businesses or reserve performance of contracts to the context of sheltered employment programmes.”

<sup>59</sup> Recital 98 provides that “Contract performance conditions might also be intended to favor the implementation of measures for the promotion of equality of women and men at work, the increased participation of women in the labour market and the reconciliation of work and private life, the protection of the environment or animal welfare and, to comply in substance with fundamental International Labour Organisation (ILO) Conventions, and to recruit more disadvantaged persons than are required under national legislation.”

<sup>60</sup> Concerning France, see the situation in 2016 in [The financing of Social and Solidarity-based Economy companies, French Chamber of Social and Solidarity Economy](#), March 2017, p. 160 and following.

- The targeting of economically viable projects in areas suffering from market failures or investment gaps. InvestEU Fund instruments will aim at attracting commercial financing to these projects.

It will also contribute to the objectives of the European Climate Pact, the cornerstone of the Union's project, since social enterprises already contribute significantly to the ecological and energy transitions (cf 1).

Finally, in the particular context of the economic crisis linked to the Covid-19 epidemic in Europe, social enterprises, many of which are in the front line of the fight against its effects on the population, especially the most vulnerable, have emerged from this crisis financially very fragile. The proposed amendment could enable Member States to support actors of economic, social and environmental inclusion in the most vulnerable territories of the Union.

### 5.2.3 The proposed exemption regime is also in line with the case law of the Court of Justice of the European Union

Taken up by the European Commission in its communication on the notion of State aid,<sup>61</sup> this case law has recognized the particular situation in which cooperative companies are placed in relation to for-profit companies with regard to the constraints that weigh on the financing of their activity:

*"Moreover, as stated at section 2.2.3 of that communication, cooperative societies have no or limited access to equity markets and are therefore dependent for their development on their own capital or credit financing. That is due to the fact that shares in cooperative societies are not listed on the stock exchange and, therefore, not widely available for purchase. Moreover, as is also made clear by recital 10 in the preamble to Regulation No 1435/2003, there is limited interest on loan and share capital, which makes investment in a cooperative society less advantageous.*

*As a consequence, the profit margin of this particular kind of company is considerably lower than that of capital companies, which are better able to adapt to market requirements."*<sup>62</sup>

The ECJ has thus concluded that a tax measure advantageous to cooperatives may not confer a selective advantage on them because the respective situations of cooperatives and limited liability companies cannot be compared.<sup>63</sup>

Since financing constraints similar to those of cooperatives also weigh on social enterprises, an exemption for the latter would be in line with the case law of the ECJ and the Notice of the European Commission.

## FAIR

FAIR was born in 2021 from the merger of Finansol, historic actor, and iiLab, innovation lab on impact. Federating social impact finance in France and representing a French expertise center abroad, FAIR gathers more than 110 social enterprises, banks, asset managers, NGO, schools and committed individuals. FAIR manages a label, the Finansol label, which helps the public distinguish social savings products from other products. Over 160 such products have been awarded the Finansol label as of today.

<sup>61</sup> Commission, Notice on the notion of State aid, 19 July 2016, section 5.4.1

<sup>62</sup> ECJ, *Paint Graphos* e. a., joint cases C-78 to 80/08, 8 September 2011.

<sup>63</sup> EESC, A. Coheur, Opinion "Towards an appropriate European legal framework for social economy enterprises", 19 June 2019, 3.2.2.3.

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