The Financial Sustainability of Social Enterprises in Romania

Author: Sonia Oprean
Editors: Zoltan Bereczki and Nicole Etchart

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Introduction

In the last 10 years, the Romanian social and economic development ecosystem has increasingly and repeatedly proposed social entrepreneurship as a solution for addressing social and economic disparities by engaging marginalized communities in the workforce. EU funded programs have invested millions of euro in the creation of social enterprises. Moreover, a number of players from the private sector (corporations via CSR programs, foundations, business accelerators, individual mentors) have also been supporting these social enterprises with start-up and, in a few cases, with growth capital and business advisory services, in order to help them address their key business challenges and strike the balance between impact and financial sustainability.

There has been growing recognition at global level that social enterprises need financial instruments that take into account the social dimensions and slower growth pace of their business models. This has resulted in a significant increase in social investment, social finance and investment readiness programs and tools for social enterprises. Unfortunately, in the Romanian ecosystem, these topics are only marginal, and few players have yet to adopt them. Romania is missing the relevant data - such as the number and size of social enterprises, financial indicators with regards to the turnover, profitability and capital employed, types of financial instruments accessible to social enterprises and how they were deployed - that would allow a full understanding of market realities. To date, no extensive and accurate quantitative and qualitative research has been performed to determine (A) the number of high-performing social enterprises in Romania, and (B) the extent to which they are prepared for scaling or ready for investment.

In order to respond to these questions, NESsT set out to assess the current status of social enterprise performance in Romania. It did this by conducting a relatively in-depth analysis of the financials of a representative sampling. The underlying hypothesis of this research was that there are a significant number of high-performing enterprises with a vision for scaling their operations and which need investment to grow. The goal of the research was to estimate the number of such enterprises in Romania, analyse their evolution in the last three years and the factors that have led to their current performance.

We hope that the results of the study and recommendations will serve to inform the sector on the steps to move forward to create an enabling ecosystem of support for Romanian social enterprises.

Financial sustainability represents the ability of the enterprise to meet its production and financial obligations while continuing to function in the foreseeable future. Social enterprises also have a social mission to fulfil, hence financial sustainability strengthens the probability that they will continue to serve the vulnerable in the long term.

DEFINITION OF SOCIAL ENTERPRISE

According to the European Commission, a social enterprise is an operator in the social economy whose main objective is to have a social impact rather than make a profit for its owners or shareholders. A social enterprise operates by providing goods and services for the market in an entrepreneurial and innovative fashion and uses its profits primarily to achieve social objectives. It is managed in an open, transparent and responsible manner and, in particular, involves employees, consumers and stakeholders affected by its commercial activities.

The Commission uses the term 'social enterprise' to cover the following types of business:

- Those for who the social or societal objective of the common good is the reason for the commercial activity, often in the form of a high level of social innovation
- Those whose profits are mainly reinvested to achieve this social objective
- Those where the method of organization or the ownership system reflects the enterprise's mission, using democratic or participatory principles or focusing on social justice

There is no single legal form for social enterprises. Many social enterprises operate in the form of social cooperatives, some are registered as private companies limited by guarantee, some are mutual, and many of them are non-profit-distributing organizations like provident societies, associations, voluntary organizations, charities or foundations.

Despite their diversity, social enterprises mainly operate in the following four fields:

- **Work integration** - training and integration of people with disabilities and/or unemployed people
- **Personal social services** - health, well-being and medical care, professional training, education, health services, childcare services, services for elderly people, or aid for disadvantaged people
- **Local development of disadvantaged areas** - social enterprises in remote rural areas, neighbourhood development/rehabilitation schemes in urban areas, development aid and development cooperation;
- **Other** - including recycling, environmental protection, sports, arts, culture or historical preservation, science, research and innovation, consumer protection and amateur sports.

The Romanian social economy law no. 219/2015 defines social enterprises as being organized separately from the public system, but contributing to the public good or to the welfare of a community through increasing the employment rates among vulnerable groups.

According to the above-mentioned law, the functioning of social enterprises is based on the following principles:

a) priority is given to the individual and social objectives;
b) solidarity and collective responsibility;
c) convergence of interests between associated members and the general interest and / or the interests of a community;
d) democratic control;
e) voluntary and free of association in forms that are specific to the social economy;
f) distinct legal personality, administrative autonomy and independence from public authorities;
g) the allocation of most profit / surplus for the financial objectives of sustainable development and provision of services to members in accordance with the general interest.

Data Sources and Limitations of Scope

QUANTITATIVE RESEARCH

The Initial Sample

The initial sample was established through **primary research** using the following methods:

1. Interviews. Peer and partner interviews, inquiries with hubs specialized in start-ups and entrepreneurship in order to collect recommendations of high-performing SEs. This method generated 12% of the sample.
2. Database 1. Screening NESsT's own database of applicants and investees that have been recorded for the last 10 years. This method generated 43% of the initial sample.
3. Database 2. The National Public Registry of Social Enterprises. This method generated 45% of the sample.

The National Registry of Social Enterprises

NESsT used the last available registry, dated March 2018, at the time of starting the research. Before closing the research in July 2018, we compared the last available registry of July 2018 with the March 2018 version. During this time no additional social enterprises were registered.

https://www.anofm.ro/registrul-unic-de-evidenta-a-intreprinderilor-sociale-iulie-2018

Financial Information

Synthetic financial statements: For the purpose of analysing the financial performance of social enterprises, we extracted synthetic financial information made public by the Ministry of Finance on their website http://www.mfinante.gov.ro/pjuridice.html?pagina=domenii.

The results of this analysis are based on the underlying assumption that the financial reporting toward the Governmental institutions was accurate and statutory accounting standards were observed and complied with by the social enterprises.

Detailed financial statements: For the purposes of detailed financial analysis of the selected sample of social enterprises, in case of nonprofits we obtained the financial statements from the entrepreneurs themselves. For limited liability companies, we purchased the financial statements from the National Registry of Commerce.

QUALITATIVE RESEARCH

We obtained the impact data (number of jobs / sustainable income opportunities for the vulnerable) through inquiry with the social entrepreneurs. For these purposes, we surveyed 143 social enterprises.

Consequently, after analysing synthetic financial statements, we interviewed a selected sample of social enterprises. We wanted to discover the commercial causes and the reasons behind their evolution. For these purposes, we interviewed 26 entrepreneurs.

The names and contact data of social enterprise representatives, other than those publicly available (for e.g. the ones listed in the Registry of Social Enterprises), will remain confidential in compliance with the Global Policy for Data Protection.

Definition of Financial Indicators

BALANCE SHEET INDICATORS

Liquidity ratio. Computed as current liabilities divided by current assets, this ratio gives an indication of the extent through which enterprises can honour short-term debt by realizing their short-term assets.

Secured grant revenue (deferred). On the face of the statutory balance sheet accounts, the position *Deferred Revenue* in the context of social enterprises and NGOs typically means the entity has signed grant contracts and revenues will flow towards the entity in the future. Recognition time depends on the funding contract terms, but typically this revenue is deemed as highly certain when recognized in the financial statements and the entity expects to cash in on those contracts in one year or more.

The *evolution of secured grant revenue* is a relevant indicator corroborated with the overall profitability of the enterprise. Allegedly, secured grant revenue levels should drop as the enterprises mature, financial results improve and the enterprises become self-sustainable.

PROFIT AND LOSS RATIOS

Percentage of other revenues in total revenues (for Ltds). Social enterprises continue to benefit from grant revenues and other forms of subsidy sometime after start-up. This ratio measures what percentage from total revenue can be attributed to other sources.

Percentage of economic activities revenue in total revenues (for NGOs). In the case of social enterprises conducting economic activities under an NGO, this ratio shows how relevant the economic activities revenue stream is and to what extent it contributes to the increased sustainability of the enterprise.

For both ratios, *the percentage evolution over the years* marks the direction of the company towards increased financial sustainability or, on the contrary, in the opposite direction, towards grant and other revenue dependency.

Percentage evolution of turnover (for Ltds) / economic revenue (for NGOs) reflects the growth of the enterprise indicating market acceptance and increased capabilities to sell.

Net profit and *net profit margin* together with their *percentage evolution throughout the years* are indicators of profitability.

Financial result from non-profit activity (for NGOs). Theoretically, the financial result from the non-profit activity of an NGO should be null. NGOs receive grants for covering their operating costs, but disbursement schedules rarely match fiscal or calendar years. Hence, an NGO can close the year at a positive financial result from non-profit activities (profit) or a negative financial result from non-profit activities (loss). In reality, though, profit or loss from the non-profit activity is not a *de facto* financial result, but represents a timing difference between the expenses and corresponding revenues. In simpler terms, a negative non-profit activity result that is not compensated by a positive non-profit activity result in a previous year signals a liquidity issue.

OPERATIONAL EFFICIENCY RATIOS

Employees are among the greatest assets of social enterprises. Empirical evidence showed that payroll costs are among the highest costs for these entities. The *revenue per employee* and its *percentage evolution throughout the years* shows the extent of turnover the enterprise is able to generate with its current resources and whether it has improved in this effort throughout the years.

Research Methodology

We have used primary quantitative and qualitative research methods. A summary of the stages of the research is presented in Illustration 1.

PHASE 1: DEFINING THE TARGET POPULATION AND SOURCING THE INITIAL SAMPLE

The target population of the assessment was Romanian social enterprises, as defined on page 2, namely non-profits and small and medium enterprises that create jobs or offer income-generation opportunities to vulnerable communities.

Illustration 1
Phases of the research

	1	2	3	4	5	6	7
Phase	Defining the population and sourcing initial sample	Gathering brief financial and impact data for the initial sample	Pre-selection on defined criteria	Financial analysis of pre-selected social enterprises	Aggregation of financial indicators based on relevant trends	Selection for detailed analysis	In depth analysis
Data Sources	National Registry 45% NESsT database 43% Partners 12%	Financial: Ministry of Finance Portal Impact & other: interviews	Sample generated at Phase 2	Sample generated at Phase 3 Ministry of Finance	Sample generated at Phase 4	Sample generated at Phase 4	Sample generated at Phase 5
Data	**Collected:** SE name, fiscal code, incorporation year, contact data	**Collected:** Revenue & financial result at Dec 2017, No. of employees 2017 (including vulnerable)	**Generated sample:** SEs that Incorporated no later than 2015, Turnover 2017 >= 50,000 RON, No. of vulnerable employees >=3	**Collected:** Individual balance sheets of SEs **Generated:** relevant financial indicators	**Generated:** aggregation of relevant financial indicators on incorporation type, activity area, incorporation timeframe	**Generated:** Successful SEs (13) Unsuccessful SEs (10) Unpredictable selection (9)	**Collected:** Qualitative aspects related to performance derived through individual detailed financial statements and interviews with entrepreneurs
Sample Size	228	143	56	56	53	32	32 analysed 26 interviewed
Research Method	Quantitative	Quantitative Qualitative	Quantitative	Quantitative	Quantitative	Quantitative	Qualitative

Our objective in this phase of the research was to identify the relevant and already established social enterprises. Our expectation, based on our 10 years of track record in the ecosystem, was that the initial sample would contain at least 150 social enterprises.

The methodology for establishing the initial sample included:

1. Interviews. Peer and partner interviews, inquiries with hubs specialized in start-ups and entrepreneurship in order to collect recommendations of high-performing SEs. This method generated 12% of the sample.
2. Database 1. Screening NESsT's own database of applicants and investees that have been recorded in the last 10 years. This method generated 43% of the initial sample.
3. Database 2. The National Public Registry of Social Enterprises. This method generated 45% of the sample.

From these sources combined, we identified 228 social enterprises as the initial sample.

PHASE 2: GATHERING BRIEF FINANCIAL AND IMPACT DATA FOR THE INITIAL SAMPLE

Our goal in this stage was to determine the number of high-performing social enterprises out of the initial sample of 228 social enterprises. In order to achieve this goal, we analysed the financial and performance data of latest closed fiscal year ending December 31, 2017.

We excluded the following social enterprises from the sample:

- Organizations incorporated as non-banking financial institutions listed in the Registry of Social Enterprises (also known as Community Mutual Funds);
- Organizations that did not submit their financial statements for the financial year 2017;
- Organizations which did not answer our call;
- Organizations which were closed down;
- Organizations which could not be contacted at all due to invalid phone numbers and inexistent website;
- Organizations which did not fall within the area of impact (for e.g. NGO specializing in consulting for EU funds application);
- Organizations that had no employees in 2017.

Hence, by excluding these social enterprises, the initial sample was reduced to 143 social enterprises.

We also excluded non-banking financial institutions listed in the National Registry of Social Enterprises, also known as Community Mutual Funds, as their social mission falls outside the scope of this study.

Our in-depth analysis considered the following areas of performance:

- Profitability;
- Liquidity;
- Financial support;
- Social impact.

We observed the same areas of performance in screening the initial sample and collected the following data for the baseline year:

Profitability

- Turnover of Ltds / revenue from economic activity of NGOs for 2017 (last statutory balance sheet submitted to the Romanian authorities);
- Profit / loss (for Ltds) / Financial result from economic activity (NGOs) for 2017;

Financial Support

- Amount of other revenues earned in 2017;

Social Impact

- Total number of employees in 2017;
- Total number of employees performing work in the economic activity area in 2017 (for NGOs);

- Total number of vulnerable employees in 2017.

The financial results and the number of employees indicator were collected from the financial statements posted on the Ministry of Public Finance's portal for each enterprise. http://www.mfinante.ro/pjuridice.html?pagina=domenii.

Interview Procedure

In most cases, we were unable to extract and determine the number of vulnerable employees in 2017 from the publicly available data. The same held true for the source of other revenues. Therefore, we have obtained this information through interviews.

We shortlisted a number of enterprises that met the following two criteria:

- Submitted their financial statements for the last fiscal year: 2017;
- Reported at least 1 employee in 2017.

The brief interview questions prepared were:

- What was the number of vulnerable people employed by the enterprise as of December 31, 2017?
- What was/were the source(s) of other revenues recorded in the balance sheet as of December 31, 2017?

We contacted social enterprises by phone. In case two calls made on two different days at two different times of the day went unanswered and unreturned, we contacted the social enterprise by email, explaining the purpose of our study, stating the areas of interest and requesting a short phone call. In case of no reply, we pursued a follow-up call in an interval between 1 and 3 days from the date of the email. In case the follow-up call went unanswered and unreturned, we excluded the social enterprise from our study.

While our purpose in this phase was to obtain quantitative information about the number of vulnerable employees working at the enterprise and the sources of other revenues, a number of performance related, qualitative findings surfaced from our interviews (e.g. the effect of changes in legislation on the performance of the business, aspects of EU funding). These findings are reflected in *Other qualitative information derived through brief interviews* (page 17) and in the last section of this report.

Through this process, we were able to obtain the needed information for the entire cohort of 143 social enterprises.

PHASE 3: PRE-SELECTION ON DEFINED CRITERIA

In this stage of the research, we aimed to reduce the sample to a number of social enterprises that are beyond the blueprint stage and are either validating their products or preparing to scale.

The 143 social enterprises comprised in the initial sample were filtered using the following criteria:

- **Incorporation year**: **no later than 2015 (inclusive)**; for NGOs conducting economic activities, we only considered those that generated an income stream starting with 2015 at the latest. We focused on social enterprises that have been existing for at least 3 years as this is the timeframe needed by enterprises to validate their products and gain market traction. Moreover, for investigating trends and variations, a period of at least 3 years was also necessary to perform a conclusive analysis.
- **Turnover in 2017**: **min. 50,000 RON / year**;
- **Number of employees from vulnerable communities**: **minimum 3.** This information was sourced by directly interviewing the representatives of social enterprises.

The initial sample of 143 social enterprises was reduced to 56 social enterprises that passed the criteria defined above.

PHASE 4: FINANCIAL ANALYSIS OF PRE-SELECTED SOCIAL ENTERPRISES

The objective of this phase of our research was the measurement of social enterprise performance from a quantitative perspective. The question at this stage was “*How are social enterprises performing from a financial perspective?*”, and we focused on analysing the following indicators:

- Profitability:
- Liquidity;
- Financial support;
- Social impact.

Synthetic financial statements were collated in a partially-automated template. The following ratios and their evolution within the period 2015-2017 were computed for analysis:

Balance Sheet Indicators

- Liquidity ratio;
- Secured grant revenue (deferred).

Profit and Loss Ratios

- Other revenues as a percent of total revenues (for Ltds);
- Economic activities revenue as a percent of total revenues (for NGOs);
- Percentages of the turnover evolution (for Ltds) / economic revenue evolution (for NGOs);
- Net profit and net profit margin together with their percentage evolution throughout the years;
- Financial result from non-profit activity (for NGOs).

Operational Efficiency Ratios

- Economic revenue per employee

We have sourced the last three balance sheets and profit and loss statements (2015-2017) from the Ministry of Public Finance portal http://www.mfinante.ro/pjuridice.html?pagina=domenii.

We have analysed the entire cohort of 56 social enterprises in this phase of the research.

PHASE 5: AGGREGATION OF FINANCIAL INDICATORS BASED ON RELEVANT TRENDS

We identified a series of similarities between the individual financial performance of social enterprises and aggregated their results on several relevant categories.

We have aggregated data on the following criteria:

- **Geographical spread.** For the initial sample, we aggregated the turnover / economic activities revenue, financial result (from economic activity for NGOs), total number of employees and total number of employees from vulnerable backgrounds to determine the most ambitious and promising counties in terms of financial performance and impact numbers generated by social enterprises.
- **Incorporation type.** In Romania, social economy activities were initiated by NGOs, generally large and reputed organizations in the development field established before 2010, some of them as early as the 1990s, with an objective to reduce organizational dependency on grant capital. Today, however, the business models in the social economy sector have diversified. Grant capital made available by the European Union has incentivized other structures to pursue social driven goals and these entities consider themselves to be social enterprises. We therefore expanded the initial sample of NGOs to include a large number of limited liability companies with a social mission. As a result, it became necessary to conduct a separate analysis for each of the two categories. This analysis applied to social

enterprises pre-selected at Phase 3 of the research.

- **Area of activity.** The financial performance indicators of top social enterprises pre-selected on criteria described at Phase 3 of the research were aggregated on 3 pillars of activity: production, services and commerce.
- **Incorporation timeframe**.
- **Most successful social enterprises / least successful social enterprises**. This analysis applied to social enterprises selected for detailed analysis as described in Phase 6.

We have aggregated the result of 53 social enterprises based on the criteria listed above. Three social enterprises were identified as outliers, having exceptionally high turnover and excluded from the data aggregation.

PHASE 6: SELECTION OF SOCIAL ENTERPRISES FOR DETAILED ANALYSIS

Financial success might be a common denominator, but the reasons behind the performance of successful enterprises proved out to be very different. The same holds true for less successful social enterprises. Many qualitative aspects surfaced from the detailed analysis of individual balance sheets. Hence, we have selected social enterprises out of the pre-selected enterprises filtered through criteria defined at Phase 3 of the research.

The selection of social enterprises for in-depth analysis was made based on the following criteria:

- **Most successful social enterprises.** Social enterprises that had a positive financial result for 3 consecutive years (2015 – 2017) were selected in this sample.
- **Least successful social enterprises.** Social enterprises that incurred losses (negative result from commercial activities for NGOs) for 3 consecutive years (2015 – 2017) were selected in this sample.
- **Unpredictable selection**: social enterprises that had unusual variances of their financial indicators. We selected enterprises with volatile margins, switching from profit to loss and vice versa.

We have filtered the 56 social enterprises through the above-mentioned criteria and selected:

- Most successful social enterprises: 13;
- Least successful social enterprises: 10;
- Unpredictable selection: 9.

PHASE 7: IN-DEPTH ANALYSIS

The objective of this phase of the research was to determine the commercial causes and market realities behind the financial performance evolution, and to analyse key success factors and uncover potential challenges that may hinder future growth of the social enterprises.

We obtained detailed financial statements from the social entrepreneurs or from the National Registry of Commerce. The financial statements of the selected social enterprises were analysed individually and in aggregate. The analysis was based on the same financial indicators described at Phase 4, the correlations between them and commercial realities being analysed and explained.

Clarification interviews with entrepreneurs were conducted. Every interview was specific, as it was tailored around the performance of the social enterprise in the last 3 years. Questions during the interview typically referred to the evolution of profitability, liquidity, financial support and social impact.

We analysed 32 individual financial statements and interviewed 26 entrepreneurs.

Research Findings

ANALYSIS OF THE INITIAL SAMPLE

The initial sample contained 128 NGOs, 88 Ltds., 7 non-banking financial institutions and 5 Cooperatives. Out of these 143 social enterprises, 53 NGOs, 38 Ltds, 7 non-banking financial institutions and 4 cooperatives were registered in the National Registry for Social Enterprises, 68 NGOs and 31 Ltds were former participants in social enterprise competitions organized by NESsT and 7 NGOs, 19 Ltds and 1 cooperative were recommended by partners. In cases where one organization was part of one or more categories, the first occurrence in one category was considered in the following order: former NESsT competition candidate, National Registry for Social Enterprises, partners' recommendations.

The impact data was collected during interviews, sending email inquiries or from internally available data and other publicly available data about social enterprises.

A number of 85 organizations were excluded from the study from the following reasons:

- 7 organizations were incorporated as non-banking financial institutions (also known as Community Mutual Funds);
- 18 organizations (10 NGOs and 8 Ltds) did not submit their financial statements for the financial year 2017;
- 29 organizations did not answer our call (17 NGOs and 12 Ltds);
- 2 organizations (Ltd) were closed down;

ILLUSTRATION 2
Initial sample data sources

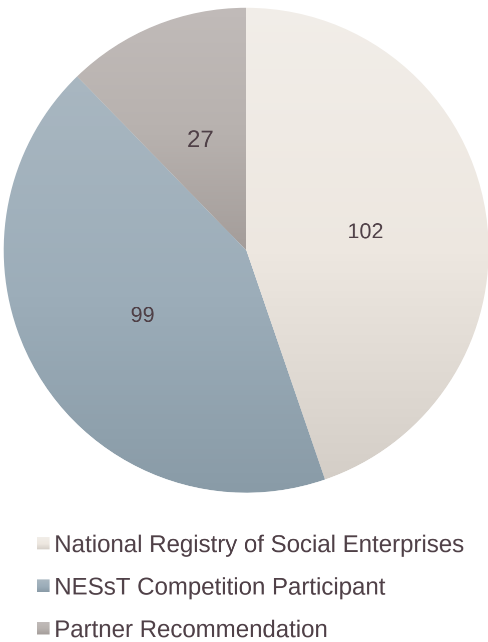
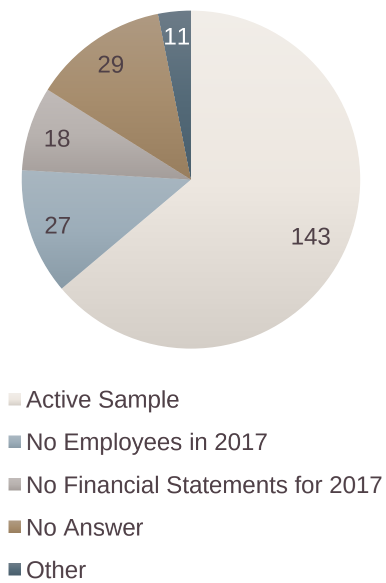


ILLUSTRATION 3
Number of social enterprises included/excluded from the initial sample



- 1 organization could not be contacted at all due to invalid phone numbers and inexistent website;
- 1 organization did not fall within the area of impact (NGO specializing in consulting for EU funds application);
- 27 organizations (15 NGOs and 12 Ltds) had no employees in 2017.

The organizations excluded from our study had an aggregate revenue from commercial activities in 2017 of approximately 8.3 million RON, about 7% from the aggregate revenue of the entire sample (see Illustration 4, below).

Therefore, the population of the research reduced at 143 organizations, 85 NGOs and 54 Ltds and 4 cooperatives (see Illustration 5, below).

We have obtained impact data and information in relation to other revenues gained by the organizations in 2017 from the following sources:

- We briefly interviewed 103 organizations, 70 NGOs, 30 Ltds and 3 cooperatives;
- We received email answers from 22 organizations, 7 NGOs and 15 Ltds;
- 7 organizations; 1 NGO and 6 Ltds were part of NESsT portfolio, hence impact data for 2017 was submitted to NESsT as part of the annual reporting process;
- 8 organizations; 4 NGOs and 4 Ltds participated in the latest social enterprise competition organized by NESsT, hence their impact data and funding data was submitted with their application;
- 3 organizations (NGOs) have the updated impact information on their website.

ILLUSTRATION 4
Turnover of social enterprises included and excluded from the research in total sample

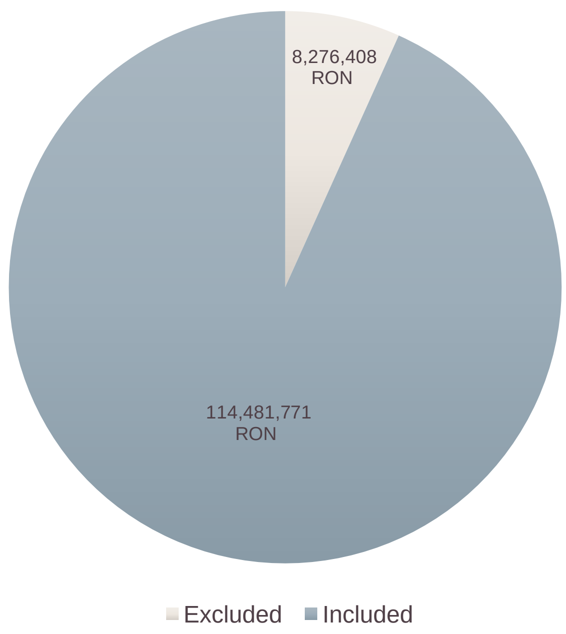
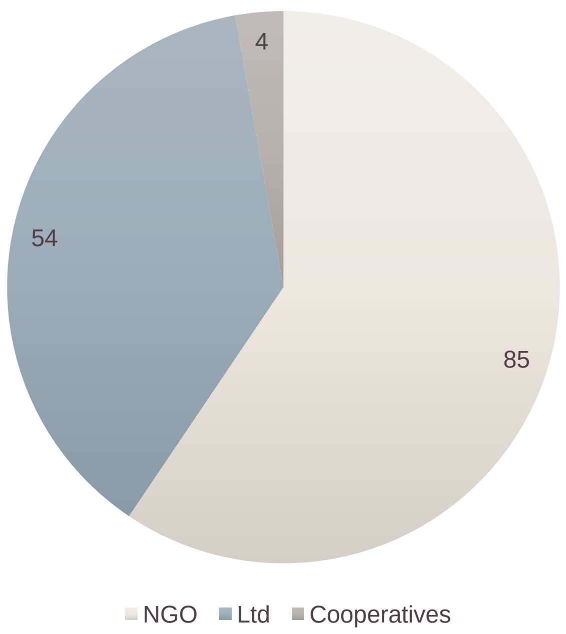


ILLUSTRATION 5
Number of social enterprises from each category included in the initial sample of 143 social enterprises

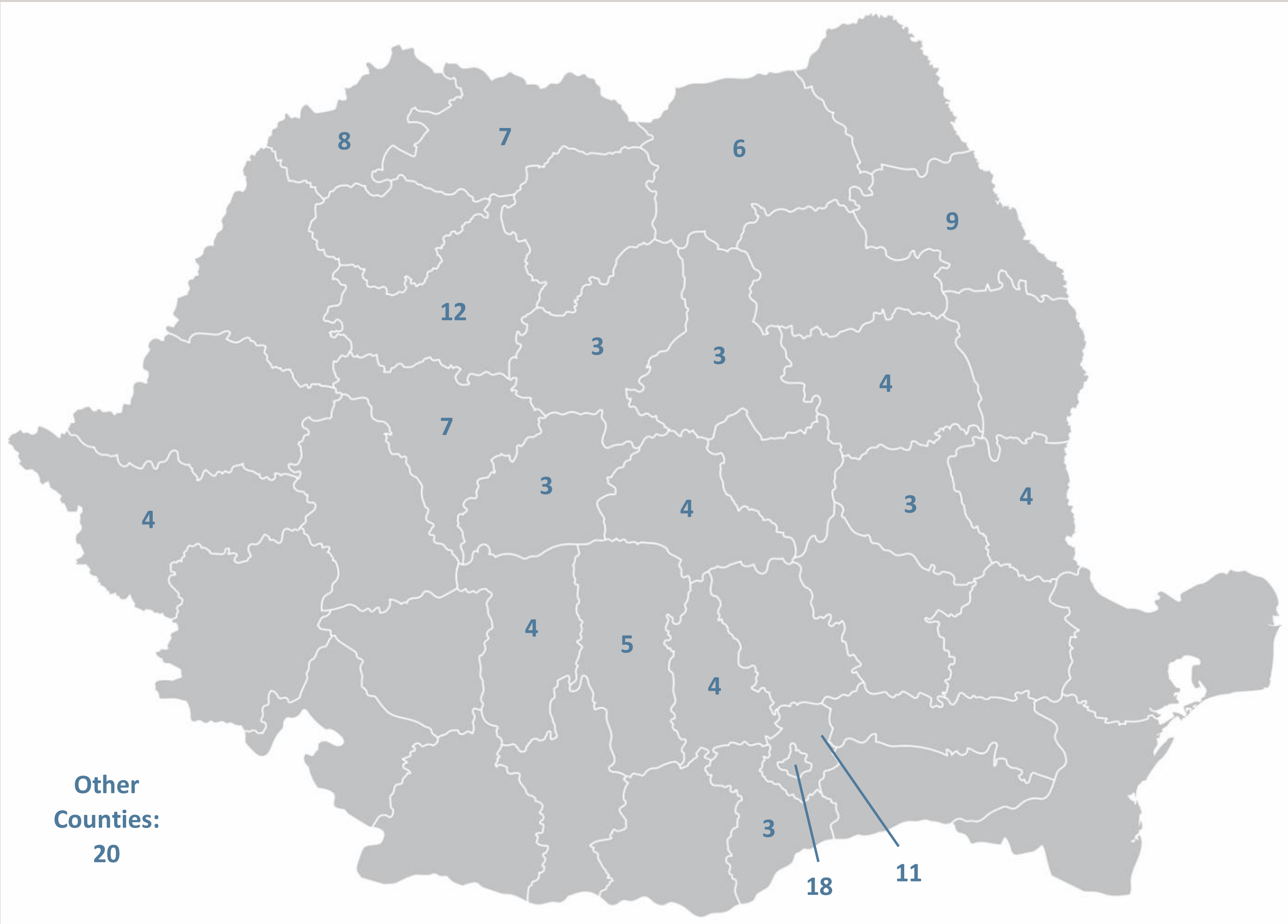


GEOGRAPHICAL SPREAD

The initial sample of 143 enterprises was spread geographically as shown in *Illustration 6*.

Eighteen (12.6%) social enterprises are incorporated in Bucharest. Cluj and Ilfov closely follow the capital with 12 and 11 social enterprises respectively, Iași (9), Satu-Mare (8) and Alba (7). Sixteen counties are grouped under the label "Other". They have an aggregate number of 20 social enterprises, between 1 and 2 social enterprises incorporated per county.

ILLUSTRATION 6



AGGREGATED TURNOVER IN 2017

The aggregated revenue from commercial activities in 2017 for the 143 social enterprises in the initial sample was 114.48 million RON (24.3 million EUR). *See Illustration 7.*

Social enterprises from Iași and Ilfov generated together 50% from this turnover, followed by Timiș with 8%, Satu-Mare and Galați accounting each for 6% of the aggregated turnover and Sibiu, Bucharest and Bacău at 4% each.

AGGREGATED FINANCIAL RESULT IN 2017

The aggregated financial result of the sample in 2017 was 4.3 million RON (915,000 EUR). *See Illustration 8.*

The best aggregate performance in terms of financial result was recorded in 2017 by enterprises in Ilfov. They recorded an aggregated profit of 3 million RON and were followed by social enterprises in Bacău, Iași, Prahova and Dâmbovița which recorded aggregated profits of 467,301 RON (Bacău), 380,503 RON (Iași), 241,802 RON (Prahova) and 212,942 RON (Dâmbovița). Contrarily, social enterprises in Timiș reported aggregate loss of 150,708 RON and social enterprises in Bucharest reported an aggregate loss of 310,020 RON.

But because aggregation as well as averaging results has its limitations, we will present the financial sustainability profile of social enterprises in this sample separately. Aggregation and averaging of results gives an indication of the size of the ecosystem and its overall trends. However, we also conducted a more granular analysis by "slicing" the sample in different ways in order to better understand the development stages of social enterprises and their specific challenges. These findings can be found later in the document.

AGGREGATED REVENUES FROM OTHER SOURCES IN 2017

In 2017, social enterprises in the interviewed sample recorded aggregate revenues from other sources in amount of **91.12 million RON (19.38 million EUR).** These came in the form of grants, subsidies and private and individual sponsorships.

ILLUSTRATION 7
Aggregate commercial revenues in 2017

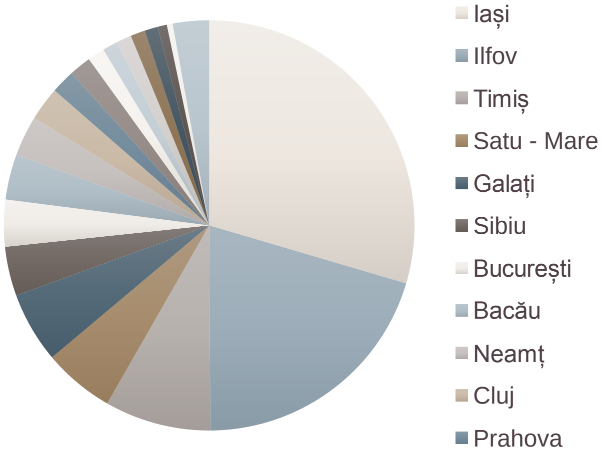
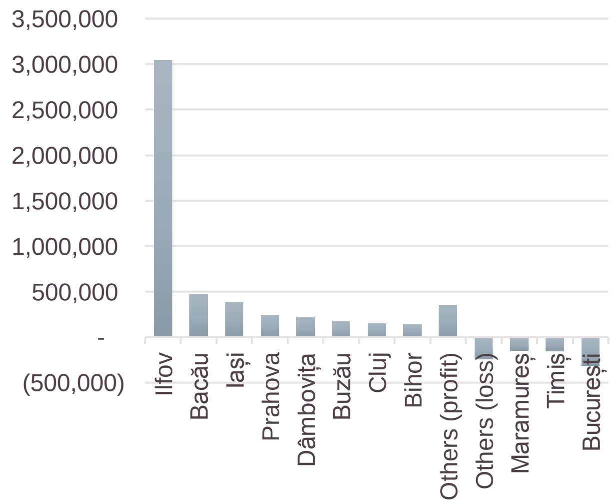


ILLUSTRATION 8
Aggregate commercial activity financial result in 2017 of social enterprises split on counties



TOTAL NUMBER OF EMPLOYEES IN 2017 AND AREAS OF IMPACT

In 2017, the 143 social enterprises employed 2,022 people out of which 692 (34%) came from vulnerable backgrounds. There were 25 social enterprises with 0 employees coming from vulnerable backgrounds in 2017. The social enterprises that did create impact in terms of employment for marginalized groups hired on an average 45% people belonging to these groups. *See Illustration 9.*

A distinct business model is represented by social enterprises that offer opportunities for earning sustainable income to vulnerable communities through supplier models. In the interviewed sample, these were social enterprises ensuring access to markets to rural producers (2), enterprises bringing to market products made by local producers / rural artisans (7) or social enterprises purchasing raw material to manufacture their products from marginalized communities (5). In 2017, these 14 social enterprises offered dignified income to 293 people in their supply chain.

Social enterprises interviewed impact more than one vulnerable group at a time. The main categories of vulnerable people offered employment and / or sustainable income opportunities defined by the interviewees were:

- At-risk youth
- At-risk women
- People with disabilities
- Unemployed / Long term unemployed
- Unemployed over 50
- Roma
- Single parent
- Subsistence revenue earner
- Rural with very limited options
- Rural producers
- Rural artisans.

Some vulnerable groups enjoyed increased support from social enterprises. Within the interviewed sample, 28 organizations worked with at-risk women, 27 organizations employed people with disabilities and 15 organizations had at least one Roma employee. *See Illustration 10.*

ILLUSTRATION 9
Impact of 143 social enterprises within the initial sample in terms of people employed

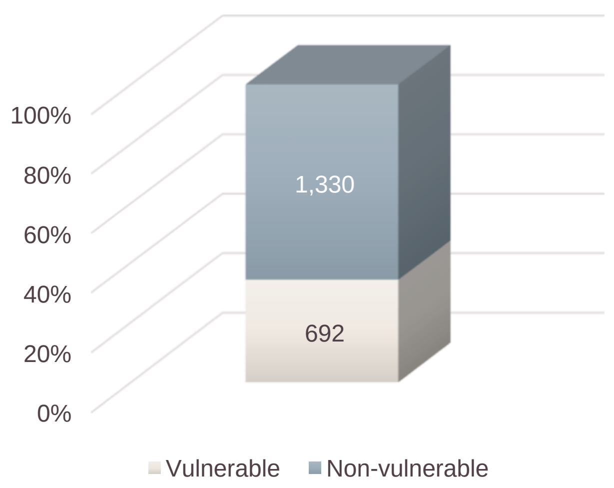
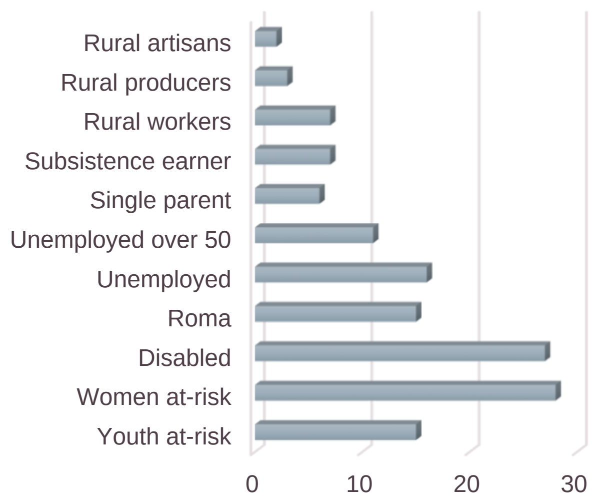


ILLUSTRATION 10
Number of social enterprises addressing various areas of impact



Social enterprises in Bacău county had the highest aggregate impact, employing a number of 129 people from marginalized communities. Social enterprises in Iași, Cluj and Vrancea present high aggregate impact numbers providing jobs to 62, 53, and 51 people respectively. The capital city, Bucharest is on the 6th place after Ilfov. Social enterprises within the sample with headquarters in the capital city employ 39 vulnerable people. *See Illustration 11.*

FINANCIAL SUSTAINABILITY PROFILE OF SELECTED SAMPLE

As mentioned in the earlier chapters, the social enterprise sector in Romania started modestly through the discrete initiatives of NGOs establishing revenue making arms, with the objective to reduce dependency of external grant funding. Aggregate financial results and impact data are important as they show the extent to which the sector has grown.

An aggregate turnover of 24 million EUR is a significant amount which demonstrates that social enterprises, at least some of them, are capable of producing goods and services that sell and sustain impact in marginalized communities in the long run.

However, in order to determine a certain degree of financial maturity among the sample, it is important to deepen the analysis by assessing revenue and profit size of individual social enterprises.

In 2017, 63 social enterprises (45% from the total sample of 143 social enterprises analysed) earned below 100,000 RON in turnover, 46 social enterprises earned between 100,000 RON and 500,000 RON, 15 up to 1 million RON and only 5 enterprises hit above 5 million RON in commercial revenues. *See Illustration 12.*

ILLUSTRATION 11
Number of employees from vulnerable backgrounds employed by social enterprises from various counties

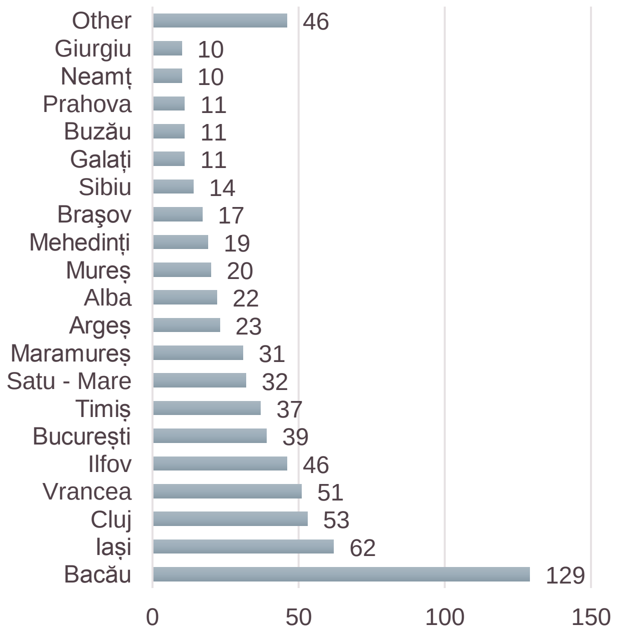
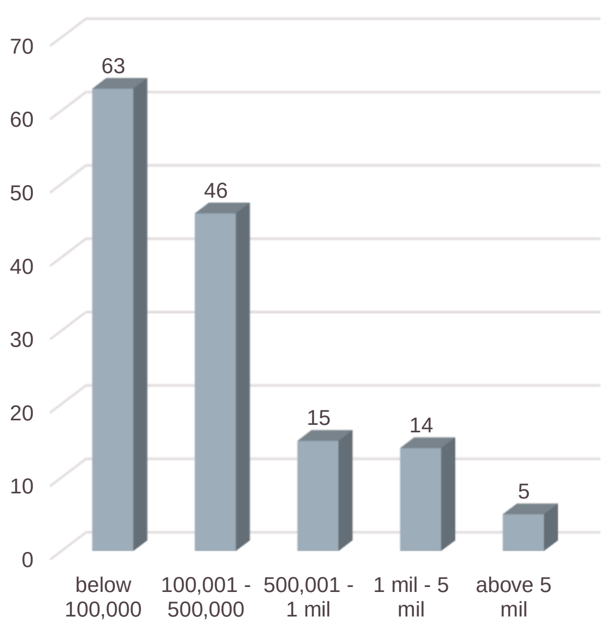


ILLUSTRATION 12
The 143 social enterprises within the initial sample divided based on their turnover in 2017



In terms of profitability, in 2017, 44 social enterprises in the analysed sample were making a loss, 21 reached breakeven and 24 enterprises managed to obtain profits above 50,000 RON. *See Illustration 13.*

We have identified 3 outliers, social enterprises with financial results that exceeded by far the results of their peers. These enterprises will be excluded from the aggregate analysis based on incorporation type, activity area and incorporation year in *Analysis of financial performance of top social enterprises* (page 19), but qualitative comments regarding their success and explanation of their rampant evolution will be presented as success factors in *In-depth analysis of social enterprises* (page 33).

The aggregate commercial revenue of enterprises identified as outliers in 2017 was 55.77 million RON, hence accounting for 49% of the aggregated commercial revenue of the analysed sample. In 2017, these 3 enterprises have posted 3.25 million RON as aggregate profit, accounting for 76% of the aggregated financial result of the analysed sample. In summary, 2% of social enterprises generate 49% of the sample's turnover and 76% of their aggregated financial result.

The chart in *Illustration 15* presents the distribution of social enterprises based on their turnover and financial result. The outliers have been excluded from this map.

It can be easily observed that the majority of social enterprises in the sample earned revenues of up to 500,000 RON and positioned themselves around the breakeven point, with financial results ranging from 100,000 in loss to 100,000 in profit.

Fifty-one (35%) social enterprises earned up to 500,000 RON in revenues and reported up to 100,000 RON in profit and 51 social enterprises (35%) earned up to 500,000 RON in revenues reporting losses of up to 100,000 RON. Four social enterprises reporting relatively high revenues, 1.7, 2.1, 3.6 and 3.8 million RON positioned themselves around breakeven point.

ILLUSTRATION 13
The 143 social enterprises within the initial sample divided based on their financial result in 2017

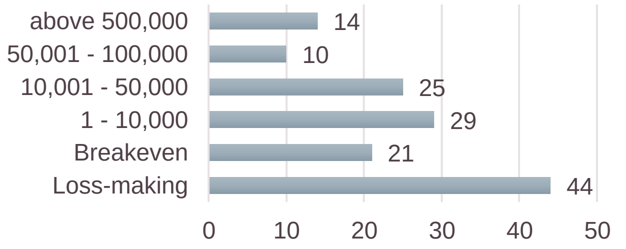


ILLUSTRATION 14
Aggregate turnover and profit of outliers in total aggregate turnover of the initial sample in 2017

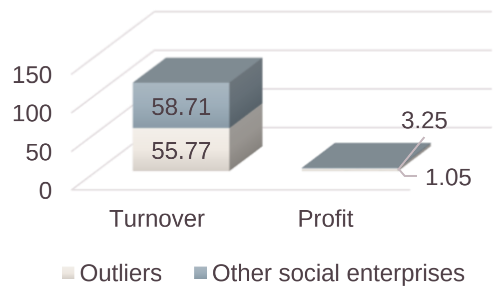
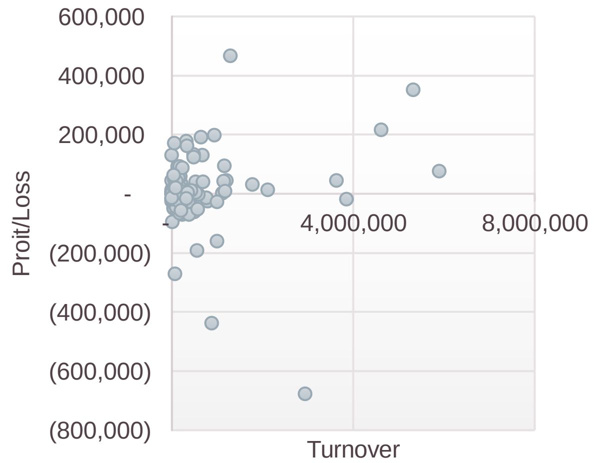


ILLUSTRATION 15
Turnover and profitability spread in 2017



OTHER QUALITATIVE INFORMATION DERIVED THROUGH BRIEF INTERVIEWS

Social Enterprises that Used EU Funds for Start-up

Fourteen Ltds and 10 social economy structures functioning under an NGO used EU grant capital to start-up commercial activity. Under the financing contracts with the EU, social impact, translated in number of vulnerable people employed, was a mandatory metric. The aggregated impact indicator referring to number of jobs provided to marginalized people for the 24 social enterprises was 127 (75 for the Ltds and 52 for the NGOs).

The majority of social enterprises interviewed did not manage to sustain the newly created jobs beyond the implementation period of the EU funded project. By the end of 2017 only 63 jobs from the total 127 created were still active and 14 social enterprises decreased their impact from 65% up to 100% as compared to the start-up year. Social enterprises interviewed argued that the social impact indicators set to make an application competitive were very ambitious even for a commercial start-up.

ILLUSTRATION 16
EU and other start-up capital sources for the 143 social enterprises within the initial sample

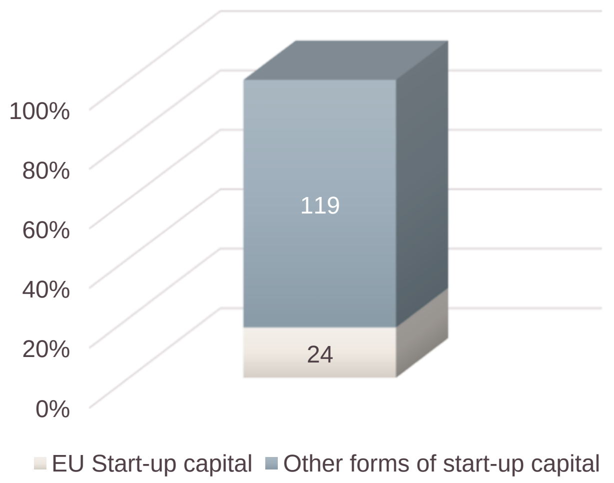
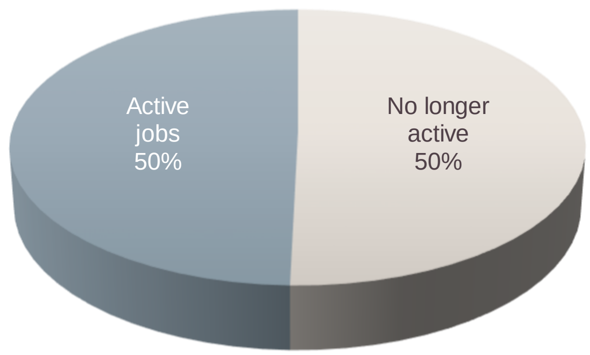


ILLUSTRATION 17
Percentage of jobs preserved by the social enterprises using EU start-up capital after the implementation period



Effects of Recently Passed Legislation on the Sustainability of Social Enterprises

Law 448 / 2006 regarding the protection and promotion of people with disabilities has provided a favourable environment for the development and growth of protected workshops. The legislative changes passed in 2017 affected almost all protected workshops in the country who have managed to secure long term partnerships with the private sector.

All protected workshops depended to a certain degree on sales made to companies with over 50 employees on the base of the fiscal advantage provided to companies by law 448 / 2006, hence all of them lost these sales in 2017 when the law was changed. A number of 5 enterprises that were counting exclusively on this turnover lost 100% of their business.

LAW 448/2006 REGARDING THE PROTECTION AND PROMOTION OF PEOPLE WITH DISABILITIES

The law stated that "public authorities and public institutions, public or private legal entities that have at least 50 people employed have an obligation to provide jobs to people with disabilities in a number at least equal with 4% of the total number of employees."

Article 78 had an increased relevance for the development of the social enterprises functioning as protected workshops and hiring more than 30% people with disabilities due to the following:

(3) Public authorities and public institutions, public or private legal entities with over 50 employees that do not hire people with disabilities as required by the present law can opt for the following:
   - (a) monthly payments towards the State budget of an amount representing 50% of minimum gross salary multiplied by the number of jobs not provided to people with disabilities (4% of total number of employees).
   - (b) purchasing products or services made by people with disabilities employed in certified protected workshops in amounts equal to sums due to the state budget as defined at a).

The law was modified through OUG no. 51 / 30.06.2017 and OUG no. 60 / 04.08.2017, changes becoming applicable from the 1st of September 2017.

Article 78 suffered a notable change: the ability to opt between the a) and b) option as previously described was cancelled. Instead:

(3) Public authorities and public institutions, public or private legal entities with over 50 employees that do not hire people with disabilities as required by the present law are required to pay monthly to the State budget an amount equal with the minimum gross salary multiplied by the number of jobs not provided to people with disabilities (4% of total number of employees.

ANALYSIS OF FINANCIAL PERFORMANCE OF TOP SOCIAL ENTERPRISES

This phase of the research had as an objective the measurement of social enterprise performance from a quantitative perspective. The research question at this stage was "*How are social enterprises performing from a financial perspective?*"

To answer this question, we focused on analysing:

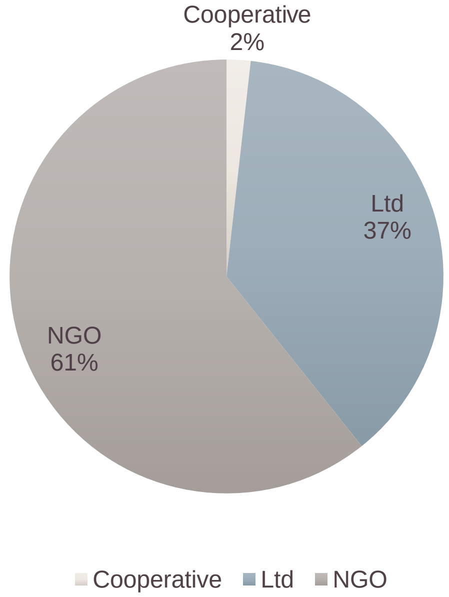
- Profitability:
- Liquidity;
- Financial support;
- Social impact.

We have selected the top social enterprises for analysing aggregate financial indicators according to the following criteria:

- **Incorporation year**: **no later than 2015 (inclusive)**; for NGOs conducting economic activities, the revenues from conducting economic activities started as an income stream in 2015;
- **Turnover in 2017** (latest available financial statements): **min. 50,000 RON / year**;
- **Number of employees from vulnerable communities**: **minimum 3.** This information was sourced through directly interviewing the representatives of social enterprises.

Fifty-six social enterprises passed these criteria: 34 NGOs, 21 Ltds and 1 Cooperative including the 2 NGOs and 1 Ltd identified as outliers in the previous chapter. The outliers have been excluded from the aggregate analysis in the following subchapters, but qualitative factors behind their success have been discussed with the entrepreneurs and will be presented as part of *In-depth analysis of social enterprises* (page 33).

ILLUSTRATION 18
The split on incorporation type of the 56 social enterprises that passed the performance criteria



AGGREGATED INDICATORS BASED ON INCORPORATION TYPE

Ltds

Profitability

The 20 Ltds in the analysed sample had an aggregate turnover of 9.2 million RON (1.9 million EUR) in 2017 and an aggregate net result of 387,480 RON profit where the net result is the sum of aggregated profits and aggregated losses.

The average turnover increased from 412,419 RON in 2015 to 422,519 RON in 2016 and 462,810 RON in 2017. Twelve Ltds in the analysed sample experienced an increase in turnover between 2015 and 2016 and 16 Ltds experience an increase in turnover between 2016 and 2017. Eleven Ltds managed a consecutive increase in turnover, thus consolidating their position on the market. The average increase in turnover of these enterprises was 240% in 2016 and 47% in 2017.

In terms of financial profitability, in 2015, 12 Ltds were profitable, 6 managed to obtain a figure around breakeven and 2 made losses.

Year 2016 brought a decrease in profitability for the analysed sample. Just 5 Ltds were profit making, 5 were at breakeven and 10 social enterprises recorded losses.

In year 2017, Ltds managed a partial recovery. Three social enterprises already profitable managed to increase their profits, 3 enterprises went from loss to profit making, 8 enterprises remained around breakeven, 2 managed to decrease their losses and near breakeven and 4 continued on a loss-making position.

ILLUSTRATION 19
Average turnover of Ltds

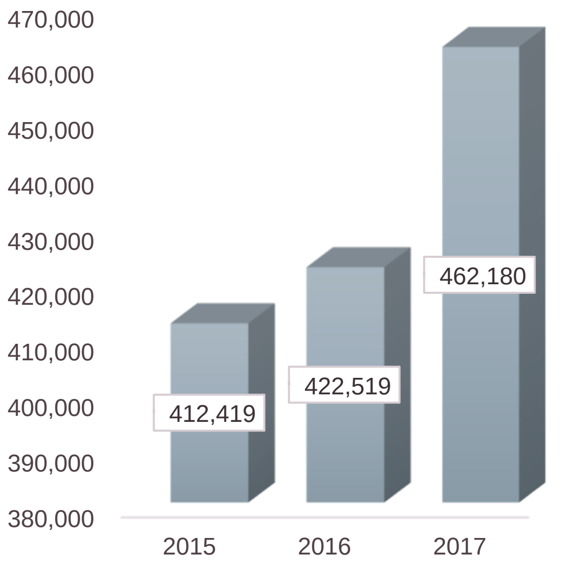
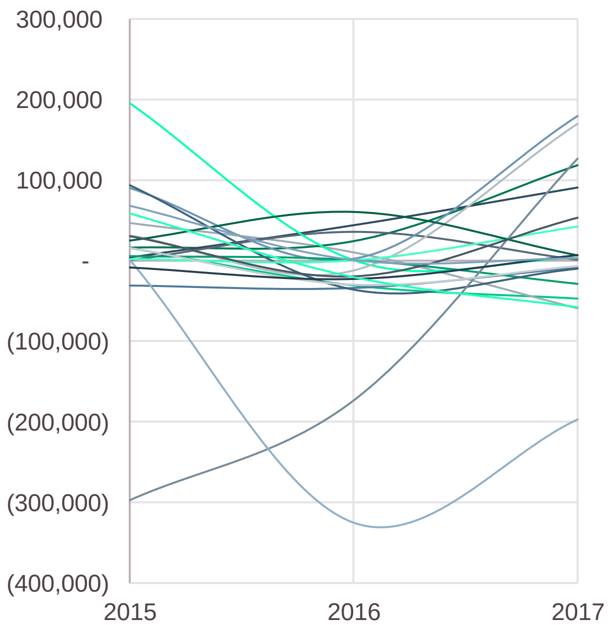


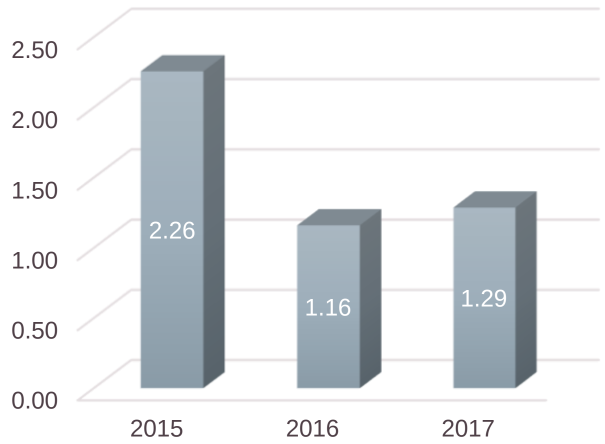
ILLUSTRATION 20
Evolution of the financial result of 20 Ltds



Liquidity
In 2017, the 20 Ltds employed net assets in aggregated amount of 3.5 million RON (744,000 EUR).

In terms of liquidity, social enterprises incorporated as limited liability companies in the analysed sample presented an average liquidity ratio of 2.26 in 2015 worsening to 1.16 in 2016 and 1.29 in 2017. Although only 4 enterprises presented negative capital for at least 1 year in the analysed period, just 2 enterprises managed to hit a liquidity ratio of 3. The majority of social enterprises maintain a liquidity ratio of around 1 which demonstrates a frequently strained cashflow position, a fact confirmed by the entrepreneurs during our interviews.

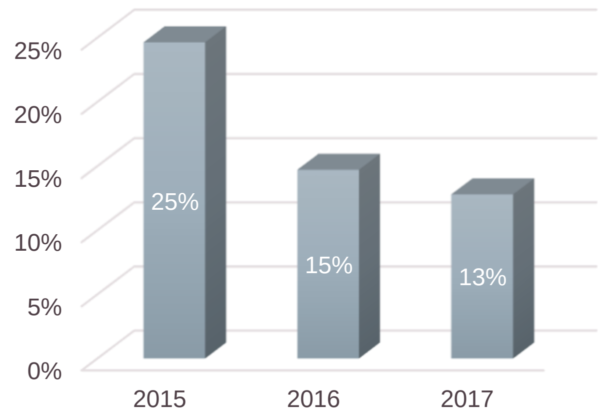
ILLUSTRATION 21
Average liquidity ratio of Ltds



Financial Support
Limited liability social enterprises also benefited from non-commercial revenues; the majority coming from non-reimbursable capital such as grants and subsidies. In 2015, 25% from total revenues of Ltds came from other sources, but this amount decreased to 15% in 2016 and 13% in 2017.

An important indicator that shows external support in terms of finance is the deferred revenue. Within the analysed sample, at year end, this figure represents secured grant revenue from signed contracts which will be transferred to the profit and loss statement in the next calendar year. At the end of 2015, 9 Ltds only recorded deferred revenues in an average amount of 241,539 RON. In 2016, 3 of these social enterprises no longer had deferred revenue balances, but the remaining 6 Ltds that continued to secure grant contracts had an average balance of 268,189 RON. In 2017, 5 social enterprises still had deferred revenues in an average amount of 270,513 RON.

ILLUSTRATION 22
Percentage revenues from other sources for Ltds

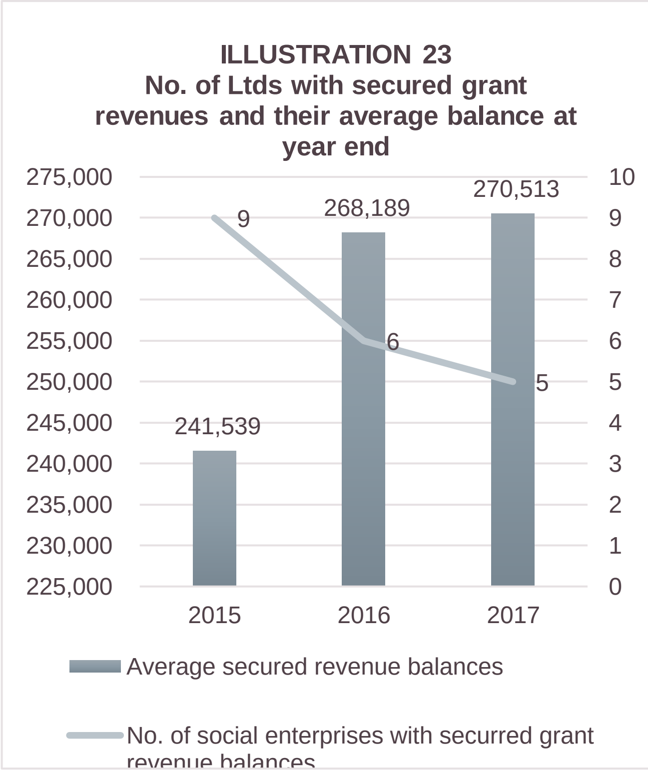


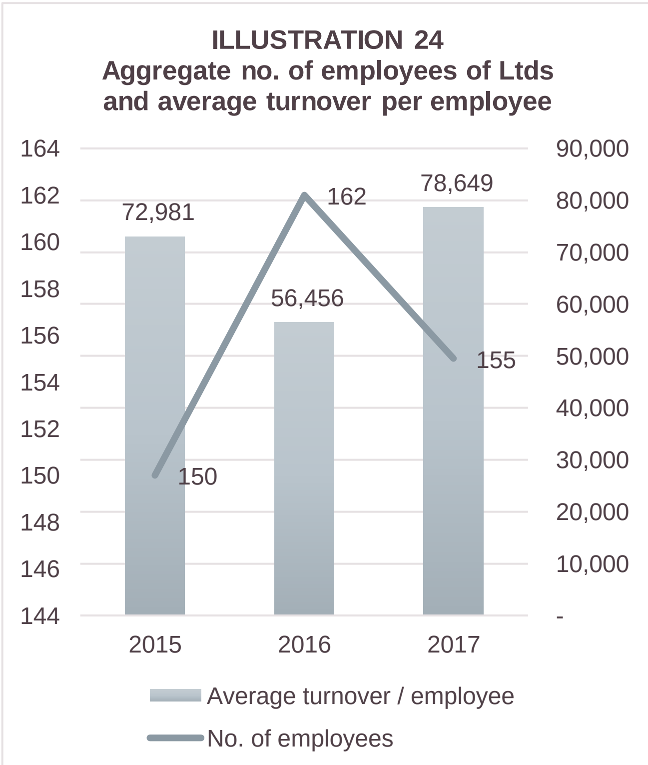
It appears that external financial support in the form of non-reimbursable capital decreased for Ltds operating in the social enterprise sphere. Year 2016 found some enterprises plunging in losses as external support decreased, but some of them proved resilient and partially recovered in 2017.

Impact and Operational Efficiency

In 2015, the analysed Ltds employed a total of 150 people with an average net turnover per employee of 72,981 RON. Nine organizations experienced 10 – 50% increases in staff between 2015 and 2016, bringing the aggregate number of employees at 162 in 2016. The average turnover per employee decreased at 56, 456 RON. In 2017, the aggregate number of employees was 155 and the average turnover per employee was 78,649 RON.

Out of 12 Ltds that experienced an increase in turnover between 2015 and 2016, only 7 hired more staff, 2 declared that they had opened positions, but didn't have success with recruitment and experienced turnover and 3 enterprises didn't hire new staff. Only 2 social enterprises that experienced turnover increases of 17% and 34% respectively, and experienced increases in staff of 50% (adding 1 more employee to the payroll), recorded a lower turnover per employee by 32% and 46% respectively. During the interviews, the enterprises explained that this was due to increased expenses with marketing and sales and not due to the lack of productivity of newly acquired talent.





At the opposite side, just 2 social enterprises that experienced turnover decrease between 2016 and 2017 hired more staff, 1 and 4 employees respectively. One of these enterprises is piloting a new commercial activity which requires initial expenditure to be validated.

Within 2016 and 2017, 15 Ltds managed an increase in turnover and 7 of these increased their number of employees by 100 to 200%. Only 3 social enterprises from this category experienced a decrease of average turnover per employee.

The average turnover per employee was contested by the social entrepreneurs as a measure of operational performance. The main argument evoked by social entrepreneurs was that as turnover levels increase more staff will be needed to sustain activity, and since a percentage of the new hires will come from a vulnerable background, they experience longer learning curves and take on an average more than 1 year to deliver on performance. Hence, the social entrepreneurs interviewed shared that it is their expectation that average turnover per employee will decrease with increases in staff. However, in the case of the analysed Ltds, we found that to be true for only 2 out of 7 enterprises between 2015 and 2016 and 3 out of 7 enterprises in the following year. While other factors might be responsible for sustaining the average turnover per employee (decrease in other categories of expense, continued growth in demand), we believe this information shows that more than 50% of social entrepreneurs managed to mitigate the increases in payroll costs and preserve operational efficiency.

NGOs

Profitability

Fifteen NGOs out of the analysed sample of 32 experienced an increase of revenues from commercial activities between 2015 and 2016. Their average increase in turnover hit 55%, a figure which excludes 1 enterprise which managed an increase in turnover of 1712% due to the fact that it operated only 2 months in 2015.

In 2017, 19 NGOs managed to increase their turnover by an average of 34%. Eleven social enterprises managed consecutive increases in their revenues, thus consolidating their position on the market.

From a profitability perspective, in 2015, 17 NGOs reported a profit from the commercial activity with values ranging from 6,000 to 322,000 RON, 6 NGOs recorded losses from the commercial activity and 9 were positioned around breakeven.

Year 2016 brought a significant decrease in financial performance for most NGOs. Just 7 enterprises managed to gain a profit from economic activity, 17 were loss making and 8 enterprises positioned themselves around breakeven.

Year 2017 brought slight increases in profitability as social enterprises making massive losses in 2016 managed to get close to breakeven. However, just 2 NGOs made profits above 100,000 RON, 6 enterprises managed a modest profit of between 10 to 50,000 RON and one social enterprise reached 94,000 RON in profit from commercial activity. Nine social enterprises continued to be loss making and 14 NGOs positioned themselves around breakeven.

Liquidity

In 2017, NGOs in the interviewed sample employed net assets in an aggregate amount of 25 million RON (5.3 million EUR).

The liquidity ratio computed as current assets divided by current liabilities is not particularly reflective as a liquidity indicator for social enterprises operating under an NGO as their balance sheet presents the aggregate assets and liabilities for the economic and the non-profit activity.

An indicator providing better information regarding the cash flow position of NGOs is the result from non-profit activity. The result from non-profit activity in theory should be null. In reality, it is very rare that payment schedules in grant financing contracts match the fiscal years. Hence, NGOs are most often reporting either a profit or a loss from non-profit activity, but this actually represents a time difference between when the expense on the grant contract is incurred and when the grant revenue is recorded. Although grant revenue is initially presented as deferred revenue and should pass to profit and loss matching the budgeted expense; in reality, due to the fact that payments are conditioned by certain milestones in financing contracts, revenue is considered certain when the payment by the financing authority is made.

Fourteen NGOs out of the 32 analysed had negative non-profit results in 2016 which did not compensate with positive non-profit results in 2015. This clearly shows a liquidity gap in 2016: non-profit making arms of NGOs experienced late reimbursements in financing contracts, a fact confirmed by the social entrepreneurs through interviews.

In 2017, 10 NGOs displayed a financing gap and 10 NGOs experienced recurring liquidity problems presenting consecutive years' negative non-profit results.

ILLUSTRATION 25
The financial result of 32 NGOs

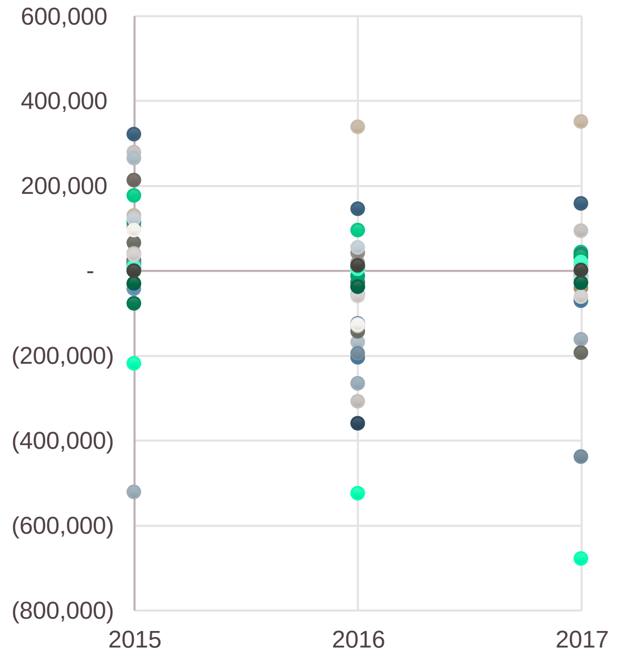
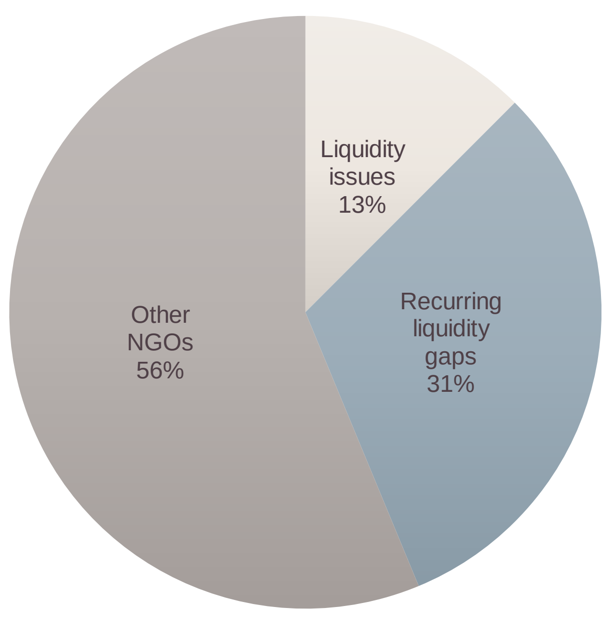


ILLUSTRATION 26
NGOs experiencing liquidity problems due to late reimbursements



One of the objectives of the commercial activity under NGOs was to provide liquidity for the NGO in case of late reimbursements. However, for only 7 NGOs was the profit gained from commercial activity large enough to cover the gap generated by the non-profit activity.

In 2016 and 2017, organizations engaged in EU funded projects experienced significant delays in reimbursement, averaging between 3 to 9 months. These organizations were badly hit due to the fact that as NGOs they could not access a commercial credit line or a bridge loan. There were only 3 exceptions within the sample we have interviewed. Two of these organizations were among the ones identified as outliers.

Financial support

In 2017, the aggregate revenue from non-profit activity was 29 million RON (6.1 million EUR).

At the end of 2015, 17 organizations had deferred revenues in their balance sheet showing financing contracts in progress. The average balance of secured grant revenue in 2015 was 972,000 RON. In 2016, only 14 organizations had deferred revenues in their balance sheet at the average of 1 million RON. In year 2017, only 12 organizations still had deferred revenue balances at an average of 896,000 RON. We have excluded from this aggregation one outlier enterprise that had 8 million RON as secured grant revenue in 2015 and 20 million RON at the end of 2017.

Data gathered shows that financing support for the analysed sample has decreased progressively in the last 3 years. Also, revenues from non-profit activities have decreased from an average of 1.4 million RON in 2015 to 1.1 million RON in 2016 and 914,000 RON in 2017. NGOs with a commercial revenue-making arm found themselves relying more on commercial revenues. The percentage of revenue from economic

ILLUSTRATION 27
No. of NGOs with secured grant revenues and their average balance at year end

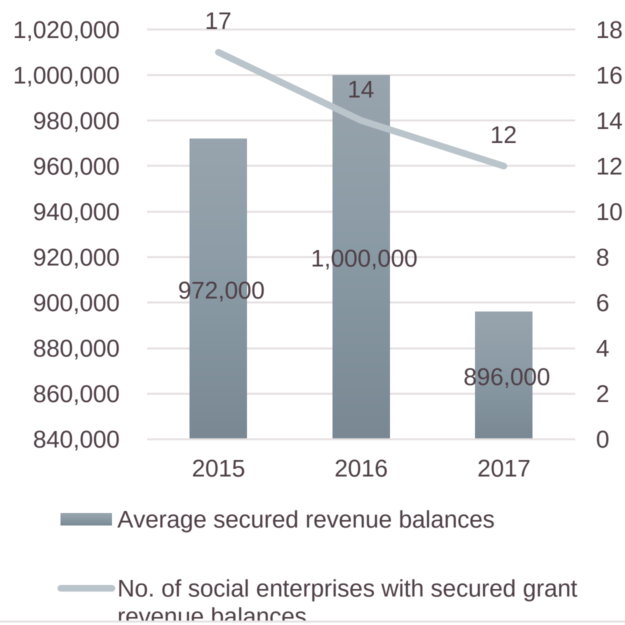
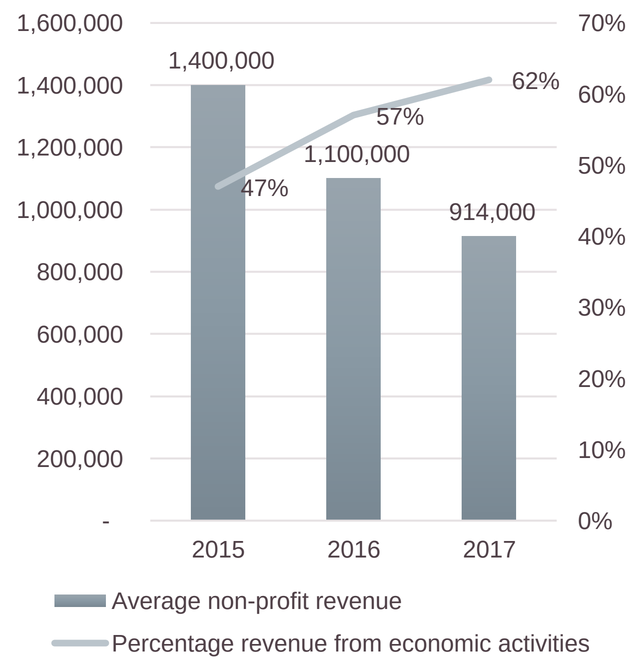


ILLUSTRATION 28
Evolution of NGOs' revenue sources



activities in total revenues increased from 47% in 2015 to 57% in 2016 and 62% in 2017.

Impact and Operational Efficiency
In 2017, the NGOs in the analysed sample employed 611 people for their non-profit activity and 304 for the commercial revenue-generating arm. The average number of employees for the non-profit activity was 22 in 2015 and decreased to 20 in 2016 and 19 in 2017. The average number of employees for the economic activity was 12 in 2015 decreasing to 10 in 2016 and 2017.

The non-profit revenue per non-profit employee figure decreased from 71,060 RON in 2015 to 70,365 RON in 2016 and 54,752 RON, consistent with the general decrease in grant financing for NGOs.

Between 2015 and 2016, out of the 15 NGOs that presented an increase in turnover, 9 hired more staff increasing headcount by 20 to 100%. The average turnover per employee decreased for 4 of them at percentages between 8 and 44%. Enterprises with decreasing turnovers adjusted their teams and recorded decreases in personnel of 11 up to 97%.

In 2017, out of 19 enterprises that experienced increased turnover, 11 hired more people between 19 and 200%. Five of them experienced a decrease in turnover per employee.

We can observe that the number of employees followed a descended trend for non-profit and economic activity arms of NGOs. It is interesting to note that the ratio of non-profit to economic activities staff is 2:1.

Cooperative

The cooperative that fulfilled the performance criteria is an agricultural cooperative. The cooperative is offering the opportunity for a sustainable income to associated members, 30 small rural farmers, working on providing them with access to markets to sell their products.

ILLUSTRATION 29
Evolution of no. of non-profit employees and non-profit revenue per employee

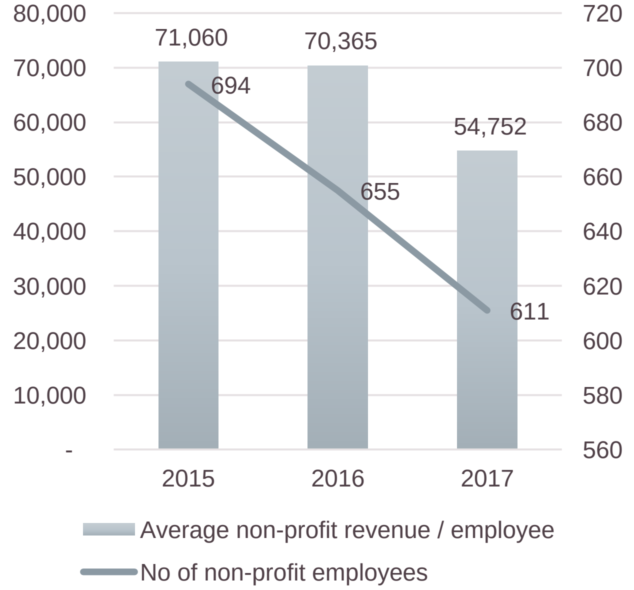
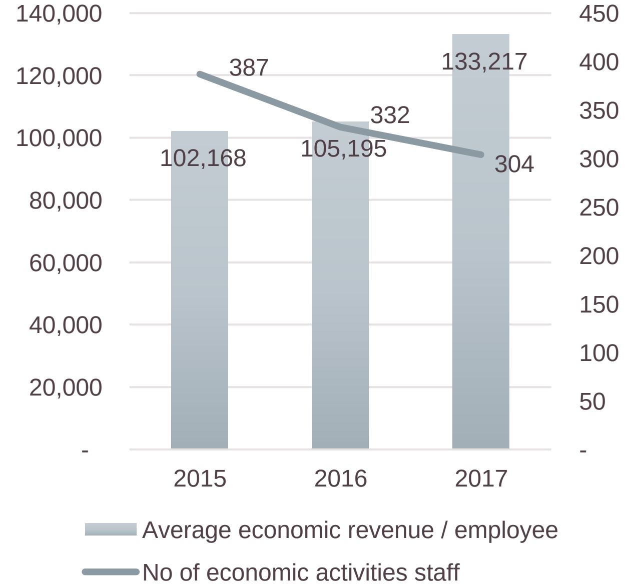


ILLUSTRATION 30
Evolution of no. of economic activities staff and economic revenue per employee



Profitability

The cooperative experienced a progressive increase in turnover from 591,000 RON in 2015 to 1 million RON (76%) in 2016 and 1.18 million in 2017 (13%). The cooperative was at breakeven in 2015 and 2016 and recorded a marginal profit of 7,586 RON in 2017, but shared that their primary objective is not profitability, but expanding their network of distribution to serve as many rural producers as possible.

Liquidity

For the entire analysed period, the cooperative presented negative capital, displaying liquidity issues. When inquired about this topic, the cooperative manager shared that debt is mainly to their suppliers, which, in this case, are small agricultural producers. The manager explained that apparent bad liquidity ratio is not a concern in their business model, as they can afford to negotiate longer payment terms with the small producers as they increase volumes purchased.

Financial Support

The cooperative enjoyed little external financial support. Only 14% of its revenues in 2015 and 2016 came from non-commercial revenues and this figure decreased to 8% in 2017.

The cooperative recorded no deferred revenues within the analysed period.

AGGREGATED INDICATORS BASED ON ACTIVITY AREA

The 53 top social enterprises were spread along 3 main activity areas: production, services and commerce.

These 3 activity areas are represented in close proportion in the analysed sample.

In terms of specific sector of activity, we found social enterprises to be quite diverse in the services and products offered (see *Illustration 32)*, hence a more granular aggregation on sector of activity would not be relevant.

ILLUSTRATION 31
Activity area of top 53 enterprises

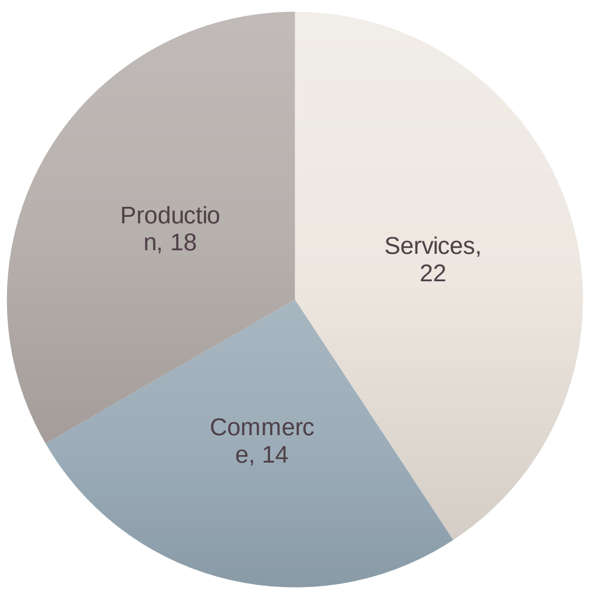
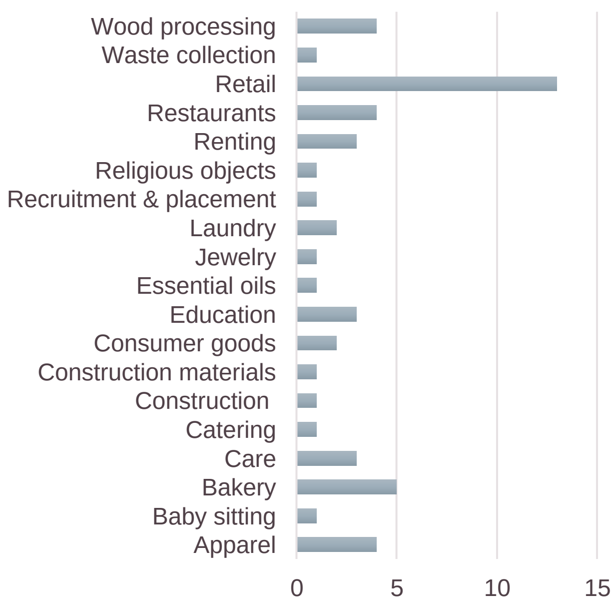


ILLUSTRATION 32
Activity sector of top 53 enterprises



Services Social Enterprises

There were 23 social enterprises operating in services within the analysed sample, 15 NGOs and 8 Ltds.

The services enterprises operated in the following sectors:

- Restaurants (4)
- Care services (3)
- Education (3)
- Renting (3)
- Laundry (2)
- Babysitting (1)
- Waste collection (1)
- Forest preservation (1)
- Construction (1)
- Catering (1)
- Printing (1)
- Recruitment & placement (1)

In 2017, their aggregate turnover was 9.4 million RON: 6.3 million RON earned by NGOs and 3.1 million RON by Ltds.

Average turnovers between Ltds and NGOs were comparable in 2015: 349,000 RON for NGOs and 460,000 RON for Ltds in 2015. In 2016, the average NGO turnover increased by 14% while the average turnover of Ltds decreased by 25%. Year 2017 brought modest increases in turnover for both NGOs and Ltds operating in services at 6% to 424,000 RON for NGOs and at 3% to 358,000 RON for Ltds.

In terms of profitability, services social enterprises' evolution was consistent with trends highlighted previously: year 2016 was a particularly difficult year, plunging many social enterprises in losses while year 2017 brought a partial recovery.

ILLUSTRATION 33
Average turnover of services NGOs vs services Ltds

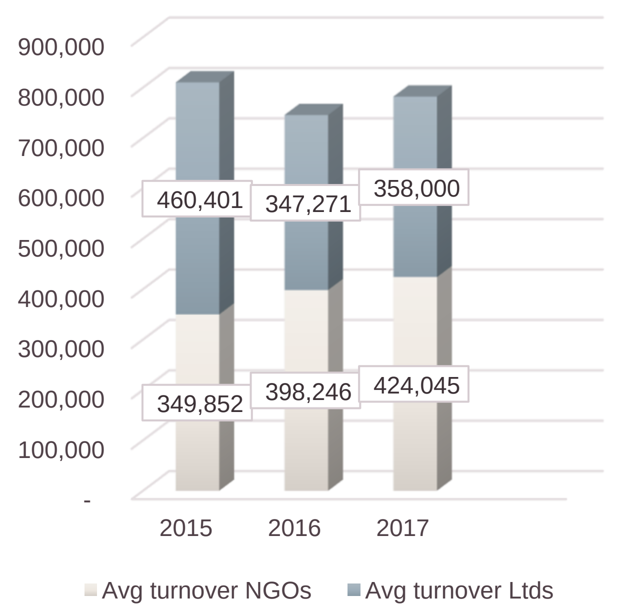


ILLUSTRATION 34
Profitability services NGOs vs services Ltds

	Aggregate turnover 2017	Ltds 3.1 mil RON (659,000 EUR)	NGOs 6.3 mil RON (1.3 million EUR)
2015	Profitable	7	8
	Breakeven	1	3
	Loss-making	0	4
2016	Profitable	1 ↓	7 ↓
	Breakeven	2 ↓	8 ↓
	Loss-making	5 ↑	17 ↑
2017	Profitable	2 ↑	9 ↑
	Breakeven	3 ↑	9 ↑
	Loss-making	3 ↓	14 ↓

The reasons for deteriorating financial performance were not unitary and social enterprises faced various commercial realities.

Five Ltds that plunged into losses in 2016 had less than or a few months above 1-year of activity being incorporated in 2014 / 2015 with start-up capital from EU. Once EU funds were exhausted, the financial results displayed the real cost of the business. These enterprises unanimously reported that the EU project implementation period placed a heavy administrative burden on the management team. Although business planning and development was supposed to be an integral part of the project, in reality these activities became the bottom of the list as administrative tasks on the management teams kept rising. Management teams were under severe cash flow pressure as reimbursements from EU funded projects were late and did not allocate adequate time to service development and client acquisition strategies. Hence, 2016 found these enterprises with unstable turnovers and insufficiently addressed pipelines.

Recently incorporated NGOs (2014 – 2015) found themselves in similar situations, but older NGOs were confronted with different problems. Two NGOs lost major contracts with public entities, while NGOs in education and care experienced staff shortage and staff turnover which impacted their ability to address demand and reach breakeven.

Last but not least, NGOs operating restaurants / catering services function at very volatile margins in a highly competitive market. For them, sustained margin performance requires periodical review of product portfolio profitability, an exercise that some of them started pursuing only in late 2017. An interesting dynamic observed by three enterprises (2 NGOs and 1 Ltd) operating as bistro / restaurant is that they have started their activity through appealing to a niche public that became a consumer due to the association of values. However, it soon became apparent that this public cannot sustain a turnover that would help reach sustainability and the enterprises had to reshape the communications and marketing strategies to appeal to a larger market.

In 2017, social enterprises delivering printing and archiving services registered as protected workshops lost significant turnover due to changes in law 448 / 2006. Care services social enterprises working with the National Health Insurance Agency were also hit by changes in partnership requirements: The National Health Insurance Agency defined a specific staff structure that care services enterprises should have in order to be eligible for contractual relationships. For start-ups, this structure proved out to be financially unsustainable and variable costs could not be covered. One social enterprise that expanded in 2016 had to close down the newly opened location due to these changes.

Two NGOs operating in cleaning services improved their performance in 2017 through a commercial strategy reorienting their sales efforts towards services with a higher profit margin and tackling private entities for sales. Bistro / restaurants also improved their performance in 2017 as a result of shifting marketing strategies and optimizing their product portfolio and supply chain. Enterprises that rented infrastructure as economic revenue had a stable turnover and profitability.

In terms of impact, services NGOs and Ltds both employed an average number of 8 people in 2015 and 2016. Limited liability social enterprises decreased this number to 7 in 2017.

Production Social Enterprises

There were **17 social enterprises** operating in production, **9 NGOs and 8 Ltds**. Social enterprises making products activated in the following industries:

- Bakery (5)
- Apparel (4)
- Wood processing (3)
- Consumer goods (2)

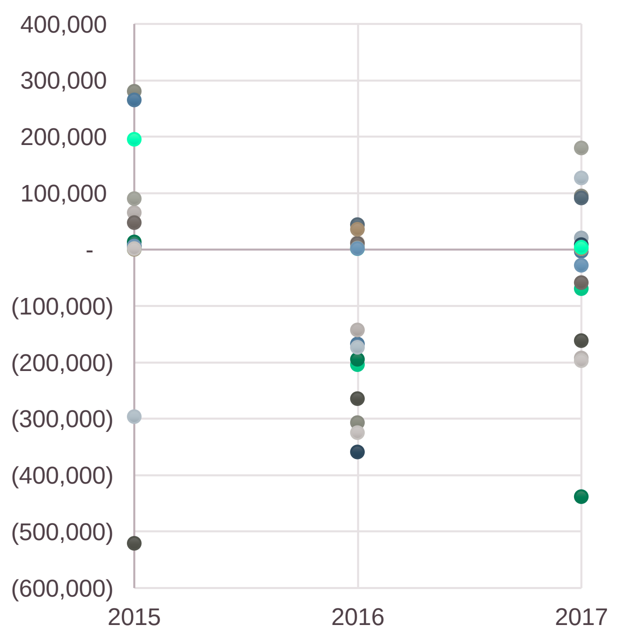
- Construction materials (1)
- Religious objects (1)
- Essential oils (1)

In 2017, they have obtained an **aggregate turnover of 10.21 million RON** out of which **4.69 million RON** was recorded by the NGOs and **5.52 million RON by the Ltds.**

The production NGOs and Ltds were comparable in size as the average volume of transactions and average number of employees show. The **average turnover for the analysed period was 619,000 RON** for the NGOs and **610,000 RON for the Ltds**.

In terms of impact, the **NGOs had an average of 16 employees in 2015, 13 in 2016 and 14 in 2017 while Ltds maintained a constant average of 9 employees throughout the analysed period**.

ILLUSTRATION 35
Financial result of production social enterprises



In terms of profitability, some performance trends were common with those of services enterprises.

In 2015, 6 social enterprises (3 NGOs and 3 Ltds) were profit making, 9 were near breakeven and just 2 (1 NGO and 1 Ltd) recorded significant losses.

In 2016, 4 NGOs suffered the post-financing effect: in the absence of grant capital the financial result revealed the real costs of the business.

However, it is important to note that within production entities in the analysed sample, for 3 NGOs and 1 Ltd the social mission prevails over the economic purpose. These entities represented that they work with the most vulnerable categories, hence it is important that they preserve employment even in deteriorating market conditions. Once it became apparent that turnovers realistically achieved in the absence of any support cannot cover the functioning costs, these social entrepreneurs made an executive decision to maintain headcount. One particular social enterprise manager declared that part of their activity will always remain subsidized as no amount of operational performance could compensate for the social cost.

Year 2017 found production social enterprises increasing financial performance with only 7 loss-making entities (4 NGO and 3 Ltds). Commercial performance oriented social enterprises managed to come close to breakeven (3 NGOs and 2 Ltds) and profit making (2 NGOs and 3 Ltds).

Commerce Social Enterprises

Commerce social enterprises are enterprises that are mainly involved in intermediating sales of consumer goods or specialized items.

There were 8 commerce NGOs in the analysed sample and 4 Ltds which were quite different in their profile. The **8 NGOs analysed were all protected workshops capitalizing their turnovers on law 448 /**

2006. In 2017, they managed to raise an **aggregate turnover of 18.9 million RON (4 mil EUR)**.

The average turnover for the 3-year period was 2.5 million RON. Their average turnover increased from 2.3 million RON in 2015 to 2.8 million RON in 2016. Within the analysed sample, half of the enterprises lost turnover and half gained as the market became more competitive with more social enterprises starting to do commerce.

A unique dynamic to the evolution of these social enterprises is the fact that most of them grew through the virtue of a distinct partnership with their suppliers. It is quite rare that social enterprises can financially afford to hire sales people. Sales efforts are usually spearheaded by the social entrepreneur and (at most) one manager. In the case of protected workshops, the social enterprises benefited from the help of an external sales force: the suppliers of merchandise brought the clients to their door. Suppliers of stationery, consumer goods, protection equipment and home deco quickly realized that law 448 / 2006 represents an opportunity for them to sell more, hence instead of selling directly to companies with over 50 employees, they came in a partnership with the protected workshop. The companies purchased from the protected workshop while at the same time complying with their obligations under law 448 / 2006 and the suppliers realized their turnover by selling to the protected workshops.

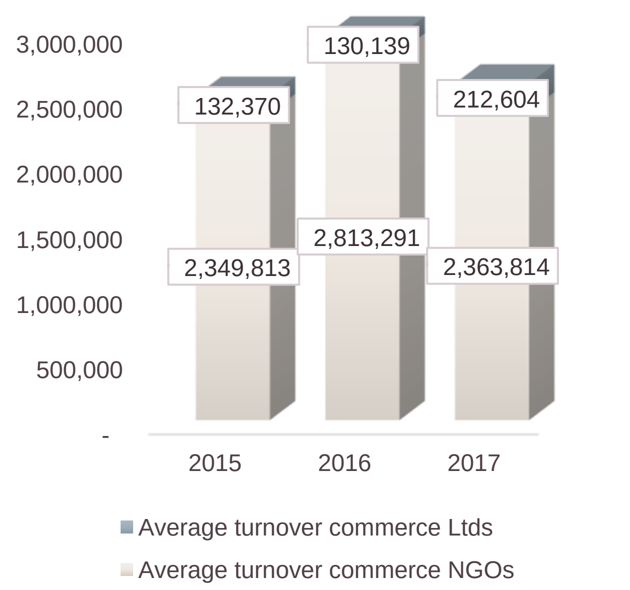
Commerce NGOs employed an aggregated number of 133 employees in 2017 out of which over 80% were people with disabilities.

In 2017, commerce NGOs lost 16% of turnover on an average, but they declare that their turnovers dropped by at least 80% in 2018. Six out of 8 NGOs reduced their staff by more than 50% in 2017, leaving people with disabilities without a job. Some of them got involved in mediation and 3 social enterprises were successful placing people with disabilities with other companies. Four out of 8 NGOs were financially sustainable making profits in 2016 and 2017.

The **commerce Ltds** have a different profile. They are significantly smaller in size with an **average turnover of 158,000 RON for the analysed period**. Their average number of employees is 4 and in 2017 they have gained an **aggregate turnover of 850,000 RON**.

Commerce Ltds sell goods to a consumer that is less aware and preoccupied by the social economy aspect. Two commerce Ltds sell jewellery made by Roma

ILLUSTRATION 36
Average turnover of commerce NGOs vs commerce Ltds



artisans, one Ltd sells sandwiches and the fourth sells second-hand apparel. The first two enterprises provide opportunities for sustainable revenues for marginalized Roma communities while the last two are employment models, hiring long-term unemployed and at-risk youth.

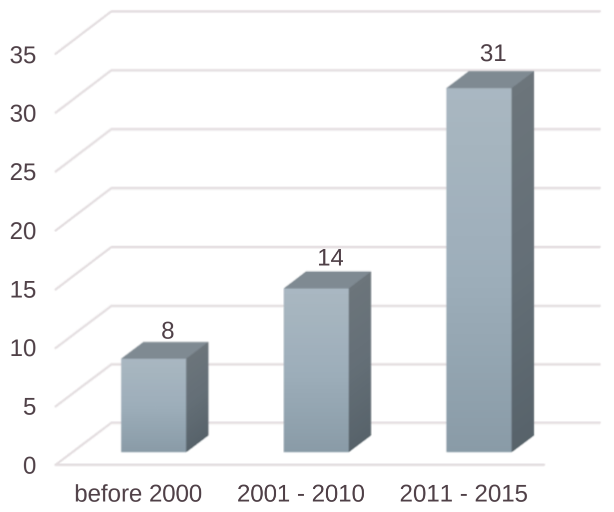
Commerce Ltds received less funding than commerce NGOs. In 2017, Ltds gathered only 658,000 RON as revenue from other sources while commerce NGOs earned an aggregate 5.7 million RON in addition to commercial revenue.

AGGREGATED INDICATORS BASED ON INCORPORATION YEAR

Based on the incorporation period, we have divided social enterprises in 3 incorporation period time brackets as shown in *Illustration 37*.

We can observe that most enterprises in the analysed sample were incorporated between 2011 and 2015. This is consistent with the national rise in EU funded programs that provided start-up capital for socially mission-driven enterprises.

ILLUSTRATION 37
Incorporation period of top social enterprises



In-depth Analysis of Social Enterprises

SELECTION CRITERIA

The selection of the social enterprises for in-depth analysis was made based on the following criteria:

- **Most successful social enterprises.** Social enterprises that had a positive financial result for 3 consecutive years (2015 – 2017) were selected in this sample.
- **Least successful social enterprises.** Social enterprises that scored a loss (negative result from commercial activities for NGOs) for 3 consecutive years (2015 – 2017) were selected in this sample.
- **Unpredictable selection**: social enterprises based on unusual financial indicators variances. We selected enterprises with volatile margin, switching from profit to loss and vice versa.

RELEVANCE OF SELECTION FOR IN-DEPTH ANALYSIS

We selected the enterprises in close proportion with the weight of NGOs and Ltds in the top 56 social enterprise sample analysed in the previous chapters (including the 3 outliers).

Hence, we selected for the detailed analysis 13 successful social enterprises (7 NGOs and 6 Ltds), 10 unsuccessful (6 NGOs and 4 Ltds) and made an unpredictable selection of 7 NGOs and 2 Ltds.

Although we did not have as an objective selecting a sample based on activity type, we analysed our selection based on this metric. As a result, the profile of the selected sample based on the activity area closely resembles the larger 56 top social enterprises sample.

Illustration 38

Sample Selection	Number	%	Proportional Selection	Successful	Unsuccessful	Unpredictable	Total	Actual Spread	Deviation
NGO	34	61%	18	7	6	7	20	63%	-2%
Ltd	21	38%	11	6	4	2	12	38%	0%
Cooperative	1	2%	1	-	-	-	-	0%	2%
Total	**56**	**100%**	**30**	**13**	**10**	**9**	**32**	**100%**	

Illustration 39

Activity Area	Top Enterprises	%	Proportion Allocation	Actual Selection	Deviation
Services	23	41%	12	14	2
Production	17	30%	9	8	-1
Commerce	16	29%	9	10	1
Total	**56**	**100%**	**30**	**32**	**2**

THE SUCCESSFUL SOCIAL ENTERPRISE

There were 7 NGOs and 6 Ltds recording a positive financial result for 3 consecutive years.

The Successful NGO

Six out of the seven NGOs were protected workshops basing their main turnover within the analysed period on the fiscal advantages provided by law 448 / 2006. These enterprises have been hit by the legislation passed in 2017 like any other protected workshop, however there are some important factors that distinguish them from their peers who have taken a more severe turn.

Half of the successful protected workshops have at least 1 other revenue stream in addition to intermediating consumer goods sales. Two social enterprises have started developing these streams a few years back, cultivating a mindset of reducing dependency on public policies and instead strengthening their offers toward customers, generating demand. One of these enterprises, although benefiting from the support of their merchandise suppliers who, as described in the earlier chapters, also lead the sales to clients on many accounts, decided to invest in reducing their dependency on these suppliers by creating an online shop. While their main suppliers initially contested this strategy, the social enterprise kept the collaboration with them and employed their own sales efforts.

The successful NGOs keep an increased attention on margins and update commercial policies accordingly. Four social entrepreneurs conducted periodic reviews of their product portfolio, decided to discard products with very low margins and focused on selling products that contributed to increased sustainability. Social entrepreneurs preferred to see their turnovers declining instead of seeing their margins eroding and did not fear replacing marketing and sales executives when margins started to erode beyond control.

It seems that most business strategies were employed to bring social enterprises closer to the performance of a commercial enterprise. However, there are a series of challenges they are facing with regards to their incorporation status. Social entrepreneurs state that the term “protected workshop” started to have a negative connotation and they prefer to avoid it. Also, as NGOs, at times they face situations wherein contracts get rejected due to the fact their clients believe it is not legal for an NGO to earn commercial revenues. While they might benefit from spinning-off the revenue making arm into an Ltd, the social entrepreneurs are reluctant to make this decision out of fear the new enterprise will lack commercial record for at least 3 years, and hence would not be eligible to apply for any external funding.

Three NGOs were incorporated before 2000, 2 were incorporated in 2001 and only 2 after 2010. Three of them employed net assets of over 3 million RON each in 2017. Net fixed assets came close to this amount. Regardless of how this level of infrastructure was built, we believe it profiles an important characteristic of successful NGOs: they are part of cohort of long-established NGOs that have had access to finance and resources.

The Successful Ltd

The profiles of successful Ltds are more diverse than those of the successful NGOs.

Two out of 6 Ltds in the analysed sample had an NGO as a majority / sole shareholder while 2 Ltds were founded by individuals with a social mission. For 2 Ltds the social impact is a partial contingency as they function in a rural setting and offer livelihoods to people in the geographical vicinity.

The two Ltds owned by NGOs have fixed assets of over 1.2 million RON each, acquisitions funded in the past by their mother organizations. One of them was incorporated in 2003 and the other in 2005.

One of them, a production company, used the fixed assets as guarantee for accessing commercial finance while the other could not do so since their assets are very specific in nature and were not accepted by the bank. This social enterprise, although relatively liquid could not access a bank loan and turned to partners from an international network for a 0% interest loan for infrastructure investment. The main shareholder though, an NGO promoting the interests and wellbeing of people with disabilities, pursued with negotiations and eventually became one of the only 3 NGOs in the interviewed sample that managed to obtain a bridge loan from a commercial bank based on a financing contract.

There are 2 success factors that distinguish these social enterprises from their more unsuccessful peers: 1) the high value-add of their products; 2) longstanding and committed teams.

1. *The value-add products*. The 2 social enterprises manage to sell high volumes through the unique features on their products: one has been making hundreds of customized products for foreign clients throughout the years (which has become their value proposition) and the other is providing a product indispensable to the medical industry. At the same time, both enterprises looked into and invested in product diversification: the first enterprise launched their own furniture brand while the second enterprise also sells mobility accessories.
2. *Longstanding and committed teams*. One social enterprise has built their sales team around former beneficiaries of the mother organization. The other social enterprise has a record in production staff longevity, about 5 years of employment, and started experiencing turnover only in the last 2 years.

SUCCESSFUL SOCIAL ENTERPRISES

KEY SUCCESS FACTORS OF SUCCESSFUL NGOS

- Revenue stream diversification
- Cultivating reduced dependence of clientele generated by fiscal advantages extended to companies
- Margin analysis and product portfolio management with an aim to focus sales strategy on the most profitable products

CHALLENGES OF SUCCESSFUL NGOS

- Negative perception of “protected workshop” term; learned to avoid it
- Spinning-off the commercial revenue making arm would limit eligibility for external financing

KEY SUCCESS FACTORS OF SUCCESSFUL LTDS

- 33% owned by an NGO, over 1.2 million RON in fixed assets
- Value-add products
- Longstanding committed management and production teams
- Used flexible private capital for start-up

CHALLENGES OF SUCCESSFUL LTDS

- Did not receive any external finance in the last 2 years
- Specialized assets, cannot be used as guarantees;
- Minor liquidity issues
- Do not access commercial debt capital due to fear of high interest rates that will furthermore compromise liquidity

Three of the remaining Ltds operate in production and 1 in services. They are all relatively young enterprises: one of them was incorporated in 2012, one in 2014 and 2 in 2015. Just one of these social / enterprises used EU start-up capital while the rest used private capital and private grants for setting up.

Three of them did not benefit from any external funding in the last 2 years. While they battle minor liquidity issues due to seasonality and production constraints, they have not reached out to commercial banks for credit lines as they believe their profits are too slim to sustain a commercial loan. Having no infrastructure to guarantee with and (in their view) not enough financial track record to be eligible in the commercial banking system, they trade on partner goodwill and the support of their administrators.

THE UNSUCCESSFUL SOCIAL ENTERPRISE

There were 6 NGOs and 4 Ltds making consecutive losses within the analysed period.

The Unsuccessful NGO

Within this category, 2 social enterprises operated in production, 2 social enterprises in services and 1 in commerce.

Four out of six social economy structures were established by organizations with a longstanding reputation in the NGO sector. Three of them were aid organizations working with the most vulnerable people and one was an advocacy organization.

In contrast with their more successful peers, it appears that the first two organizations started pursuing social entrepreneurship more as an extension of social support to their beneficiaries than as a vehicle for strengthening the financial sustainability of the organization.

These two organizations owned assets in net value of 1.6 million RON and 3.6 million RON respectively at the end of 2017, but these assets were specific to the aid activity hence only a part of them could be used as guarantees. One of these organizations had access to a commercial bank loan.

Two of the three aid organizations experienced with more than one revenue stream at different points in time, but insufficient focus on customer behaviour and product profitability kept the economic activity below the breakeven point. These social enterprises continued to function in order to serve their social mission and provide jobs for the vulnerable while drawing resources from the non-profit arm.

Three social enterprises in this category, one in production and 2 in services, although established with sustainability objectives, struggled with market conditions and stayed below breakeven in the analysed period. Although they have invested important resources in product / services development, their business models required periodical capital injections to finance either infrastructure or human related expenses (for e.g. the cost of turnover of personnel). These organizations did not benefit from external funding in the last 2 years for developing the economic activities component and traded on credit from the non-profit arm or their founders.

The Unsuccessful Ltds

Three out of 4 Ltds in this category have an NGO as the sole shareholder and 2 out of 4 Ltds used EU funds as start-up capital. Three social enterprises were incorporated in 2015 and one in 2010.

Social enterprises in this category operate in: production (1), services (2) and commerce (1).

Three of these social enterprises have very low levels of non-current assets (below 50,000 RON) while the fourth enterprise, a production unit employs fixed assets of over 4 million RON. All these social enterprises have benefited from the support of their founders in various ways: zero interest loans, free use of infrastructure and pooling of human resources or working capital.

THE UNPREDICTABLE SELECTION

Nine social enterprises (7 NGOs and 2 Ltds) presented volatile margins, significant drops in revenues followed by partial comebacks. Fifty percent of these enterprises suffered by both the effect of legislation and drawbacks of EU funding dependency in the analysed period. We can represent that enterprises in this category suffered the effects of a short-term view: based most of their turnover on a law that provided a fiscal benefit for their clients while at the same time using EU funds for start-up / development.

Although some of them provided services with great potential for financial sustainability (for e.g. premium education), their service was insufficiently defined and developed at the end of the financing contracts, hence their turnovers remained unstable and profitability questionable.

UNSUCCESSFUL SOCIAL ENTERPRISES

KEY FACTORS OF UNSUCCESSFUL SOCIAL ENTERPRISES

- Established as an extension of the social support, not necessarily with a view for financial sustainability;
- Insufficient customer and product development focus;
- Business model requiring frequent capital injections;
- Did not benefit of external financing in the last 2 years;
- Owning assets specific to the aid activity which cannot be used as guarantees.

VOLATILE SOCIAL ENTERPRISES

KEY DETERMINING FACTORS OF VOLATILE PERFORMANCE

- Turnover relying on fiscal advantages extended to companies;
- Used EU funding for start-up;
- Services / products insufficiently defined at the end of the funding period.

Conclusions and Recommendations

SUMMARY FINDINGS

Initial Sample: 143 Social Enterprises

114.48 million RON
(24 million EUR)
aggregated turnover 2017

4.3 million RON
(915,000 EUR)
aggregated financial result 2017

2% of the sample
earn 49% of aggregate turnover
and 76% of financial result in 2017

Social Impact 2017

2,022
people hired

692
vulnerable people employed

293
vulnerable people included
in the supply chain as vendors

Turnover and Profitability

70%
earn up to 500,000 RON
in commercial revenues

35%
reported losses of up to 100,000 RON

35%
reported profits of up to 100,000 RON

Top Enterprises: 56 Social Enterprises

incorporated no later than 2015

recorded a turnover/commercial activities
revenue of 50,000+ RON in 2017

hired at least 3 employees from
vulnerable backgrounds in 2017

LIMITED LIABILITY COMPANIES VS SOCIAL ECONOMY STRUCTURES OPERATING UNDER NGOS

Limited liability companies and NGOs within the analysed sample came close in terms of financial performance.

In terms of financial profitability, in 2015, 65% Ltds and 53% were profitable, 30% Ltds and 19% NGOs managed to obtain a figure around breakeven and 10% Ltds and 28% NGOs made losses. Year 2016 found both Ltds and NGOs plunging in losses. Just 30% of Ltds and 21% of NGOs were profit making, 50% of Ltds and 30% of NGOs were loss making and the rest were around breakeven.

Social enterprises regardless of incorporation type experienced the post-financing effect in 2016: as grant contracts came to an end, the real costs of the business surfaced reflecting in the financial result. Recently incorporated enterprises did not have the time to perfect their products and services and diligently address pipeline, hence the end of the financing period found them with unstable revenues. Other enterprises lost public service contracts, experienced staff turnover and struggled with thinning margins.

Year 2017 brought slight increases in profitability. Social enterprises previously engaged in EU financing contracts reduced on an average their headcount by half, cutting expenses to fit the actual size of the operation, exempt of grant support. Many social enterprises started to pay more attention to their portfolio of products and clients and shifted commercial policies to accommodate market response.

ILLUSTRATION 40
Profitability

Aggregate Turnover 2017	Ltds 9.2 mil RON (1.9 million EUR)	NGOs 30 mil RON (6.3 million EUR)
Net Assets 2017	**Ltds 3.5 mil RON (744,000 EUR)**	**NGOs 25 mil RON (5.3 million EUR)**

2015	Profitable	12	17
	Breakeven	6	9
	Loss-making	2	6
2016	Profitable	5 ↓	7 ↓
	Breakeven	5 ↓	8 ↓
	Loss-making	10 ↑	17 ↑
2017	Profitable	6 ↑	9 ↑
	Breakeven	10 ↑	9 ↑
	Loss-making	4 ↓	14 ↓

ILLUSTRATION 41
External Financial Support

No. of Enterprises with Secured Grant Income at End of Year	Ltds	NGOs
2015	9	17
2016	6 ↓	14 ↓
2017	5 ↓	12 ↓

Average Secured Revenue	Ltds	NGOs
2015	241,539	972,000
2016	268,189 ↑	1,000,000 ↑
2017	270,513 ↓	896,000 ↓

External financial support has progressively declined for both Ltds and NGOs in the analysed period.

Limited liability companies and social economy structures operating under NGOs found themselves in fragile liquidity positions within the analysed period. The reasons varied widely with the field of activity. However, one major reason that was common to many NGOs was the late payments under EU financing contracts.

Fourteen NGOs (43%) had negative non-profit results in 2016 which did not compensate with positive non-profit results in 2015. Ten NGOs experienced recurring liquidity problems presenting consecutive years' negative non-profit results. Due to this reason, many NGOs experienced delays in starting the commercial activity which left them vulnerable once the financing period was over.

The NGOs response to the liquidity crisis was to trade on suppliers' and employees' goodwill, deferring payments as much as they could. More established organizations engaged in valuable partnerships tapped into the resources of their founders' or partners to bridge the liquidity gap. One organization provided liquidity for their partners in an EU-funded project to continue the activities.

ILLUSTRATION 42
Liquidity

	Ltds	NGOs
Liquidity	Average liquidity ratio around 2	10 social enterprises experiencing recurring liquidity gaps 4 social enterprises experiencing liquidity issues
Liquidity Position	Moderately cash strained	Severely cash strapped at times

Only 3 organizations in the analysed sample have accessed a commercial bridge loan based on their financing contract.

Limited liability companies more often needed working capital to cover seasonal activity or productivity gaps. However, they were reluctant to access commercial bank loans out of fear that commercial interest rates will erode their not very robust margins.

PROFILES

Established NGOs incorporated 10 – 15 years ago are still the front runners of the social enterprise field. These organizations seem to have been the ones that capitalized the most on financing opportunities offered by the EU starting social economy structures or limited liability companies as sole shareholders. Also, they had the resources and the management capacity to continue activities when liquidity gaps started affecting the sector.

Limited liability companies founded by individuals with a social mission are financially sustainable and increased their turnovers progressively in the analysed period. Their founders invested heavily in product development and brought to market premium or highly customized products and services to a niche clientele.

The most vulnerable enterprises in the sample were the ones that relied on fiscal advantages extended to their clients under law 448 / 2006 and while using EU funds for start-up.

RECOMMENDATIONS

For Public Donors Providing Start-up Capital

Although EU programs in 2014 – 2015 were aimed at facilitating the entry of new social enterprises in the field, in reality, few newly founded social enterprises managed to reach financial sustainability once the financing contract ended. Small entrepreneurial teams found themselves allocating high amounts of time to project management and administrative issues while product development and customer acquisition were insufficiently addressed in a crucial period for the enterprise, namely the first 2 years of existence. Due to the nature of the financing terms, entrepreneurs couldn't operate changes in the strategy of the business once it became apparent that market conditions were different than the ones expected at proposal submission (for e.g. change of the location of the business).

EU funding opportunities have been successfully accessed and used by social enterprises that had institutional capacity to separate project management and core business teams, allowing the latter to focus on business development. Also, EU funding programs allowed for infrastructure purchases in many cases which provided a favourable frame for established NGOs to strengthen existing production capacity or start a new revenue-making arm.

Realistic Definition of Social Impact Metrics

Start-up capital accessed in EU financing contracts came with social impact metrics that proved to be financially unsustainable in the long run. In reality, only **half of the jobs created through EU funded projects continued to exist after the implementation period**. These programs were aimed at improving the economic situation of vulnerable communities. However, setting high impact metrics disconnected by the business reality added another layer to vulnerability: the insecurity of the workplace.

We believe that in order to increase the chances of start-ups to survive beyond the funding period, social impact metrics need to be defined taking into consideration business realities. For example, the baseline when setting the number of jobs created through a social enterprise led project should be minimally compared to the number of employees in SMEs operating in similar industries from the for-profit world. The fact that the former is employing vulnerable people, who often don't have the skills- both soft and hard- to easily transition to work, imply that the final employment goals should be even more conservative than those of SME counterparts.

Flexibility of Start-up Capital

Start-up capital needs to be flexible to allow ample time for business development. We believe that the fact that 3 out of the 6 most successful Ltds were started up with private capital is not arbitrary. While bootstrapped at the beginning, like any enterprise, these social enterprises enjoyed increased flexibility which allowed them to invest in making premium products and building important networks of clients, suppliers and distributors.

Statistically, start-ups need a lot of space for pivoting their products and services, consistently listening to customer feedback and adapting their strategies accordingly. It is crucial that providers of start-up capital understand that business plans can rarely be implemented without changes or departures from the initial assumptions and therefore give social entrepreneurs the freedom to implement actions required by changing circumstances.

For Providers of Development Capital

Social enterprises had relatively easy access to financial and operational leasing with commercial market rates for purchasing assets up to 50,000 RON. However, other type of long-term debt was hardly accessible to social enterprises.

The powerful NGOs at the forefront of the social economy structures profiled in the earlier chapters come close to eligibility in the commercial banking sector, hence we believe that they are investment ready.

However, they are reluctant to access debt capital from commercial lenders (even if they have done so in the past) due to several reasons:

1. **Interest rates**. Social entrepreneurs consider an interest rate of 7 – 10% as too high for a social

enterprise. Operating in this area of business is subject to increased risks: changes in legislation can significantly affect profitability, the unpredictable nature of social costs, liquidity issues that came to be expected when engaging the organization in EU funding programs. All these factors urge entrepreneurs to strive to maintain high cash reserves to be able to cope with all these challenges.

2. **Guarantees.** These organizations own high value in assets, but they are reluctant to use them as guarantees as they have a primarily social purpose.

Therefore, social enterprises prefer to avoid debt capital when considering development and wait for opportunities involving less financial risk.

We believe that in order to meet the demands of existing social enterprises, development capital providers should take into consideration the different development stages of social enterprises and their need for tailored capital for growth at each stage.

Adapting Risk/Return Analysis

As highlighted in our analysis, social enterprises are complex business models with a profile of high risk as compared to commercial enterprises. Social enterprises receive little subsidies and no tax cuts for the integration of the most vulnerable, hence their products and services are made at high social costs.

Therefore, a social enterprise that has reached breakeven demonstrates that it has reached a degree of operational efficiency corroborated with market traction. These factors allowed the enterprises to accept these costs and continue to stay in business.

While established social enterprises with financial power could soon become eligible in the commercial banking system, they are holding back their development to protect their margins and preserve their liquidity. Social entrepreneurs perceive there is a lot of solidarity within the ecosystem, but a lot of solitude outside it as mainstream actors do not understand the complex reality of doing business for and with the most vulnerable.

Development capital providers or, otherwise, social investors need to lower their risk profile if they want to approach social enterprises as a potential customer.

Tailored Financial Instruments

Social enterprises analysed through the present study are in very different stages of development, requiring different type of capital. We have defined several levels of development, highlighting the type of capital they needed and the conditions under which they would accept the instrument proposed.

High performing social enterprises

- Capital need: development, infrastructure, new products and services, research and development
- Size: 50,000 – 150,000 EUR
- Accepted interest rate: 3%
- Guarantees: no guarantees
- Period: 7 – 10 years
- Grace period: granted
- Within the interviewed sample: 6 social enterprises

Young medium and small social enterprises (especially NGOs), below 3 years of activity

- Capital need: bridge loan to meet cash flow under public financing contracts
- Size: depending on the financing agreement, between 10 to 50,000 EUR
- Accepted interest rate: 0%
- Guarantees: the grant contract
- Period: reimbursement scheduled synchronized with grant payments
- Within the interviewed sample: 24 social enterprises

Credit line (NGOs and Ltds) for young medium and small social enterprises

- Capital need: credit for working capital
- Size: 5,000 – 10,000 EUR
- Accepted interest rate: 3 – 4%
- Guarantees: not available
- Period: flexible, up to one year
- Within the interviewed sample: 10 social enterprises

While these are the needs of social enterprises that presented themselves open to accept external finance, there are those that have even less choice.

Thirty-two percent of the enterprises from the initial sample of 143 recorded revenues from commercial activity below 50,000 RON and 35% of this sample struggled between breakeven and modest profits of up to 10,000 RON. With declining grant capital available and without access to any other resources, these enterprises are running business at best in survival mode. Unfortunately, there is no unified national database that comprises social enterprises incorporated during the last 3 years, but we believe a volume analysis on the outputs of all EU social enterprise start-up funds from 2014 until present might reveal a larger sample of social enterprises missing the adequate financial and non-financial support to grow closer to the profile of their more successful and long-established peers.

A major flaw in public funding programs is the fact that no follow-up finance is available when the programs ended. At the end of the financial period, few social enterprises are sustainable. Entering a new phase of their development, social enterprises need patient capital to continue to design their products and services, invest in infrastructure or find solutions for specific problems of their business model.

There is a dire need of intermediate funding programs for social enterprises exiting public financing contracts or, otherwise, social enterprises that are exiting the period of 1 – 3 years of start-up. Based on their financial performance, these social enterprises are not eligible for debt capital and few grant programs are targeted at their level of development.

Data gathered showed that social enterprises, on an average, take a period of at least 5 years to become solid, liquid and confident in the future. Whether financed from public sources or private money, social enterprises should have access to financing programs that have a view to help them develop in the long run as opposed to programs designed only to bridge sustainability gaps.

The short-term view of public funding programs proved to be detrimental to social enterprises and their employees. At this stage of their development, social enterprises do not particularly need donors and investors as much as they need partners, institutions that can commit their support in the long run and can offer various type of capital as the enterprises mature while being active and engaged in shaping the development strategies together with the social entrepreneurs.

Epilogue

If you have ever participated in an investment committee, you will note with wonder that all of the investors have put the written memo aside and are examining the numbers—revenues, costs, net profit, net margins – in the spreadsheet. This is because numbers speak volume when it comes to growing sustainable businesses. They not only tell us how enterprises are performing, but also what kind of capital they need to grow and scale their impact.

The assessment of the financial performance of social enterprises in Romania conducted by NESsT does just that. It shows that social enterprises in Romania are for the most part getting by – hovering around the break-even point. However, except for a few outliers, they have not been able to get beyond this point, and begin the process of impactful growth.

The key reason for this, as demonstrated by the study, is that they lack the right capital at the right time to validate their business models, establish their cost-revenue structures, diversify their products, expand sales, and build the systems and teams needed for growth. In fact, not only do they lack this capital, but also the resources that are available to them often do exactly the opposite. Public funding that requires enterprises to create jobs overnight, but does not allow time for the development of business models to sustain these jobs, results in a 50% loss of jobs, shrinking margins, shrinking teams and overall fragility and instability once the funding is gone. Not only is this detrimental to the enterprises, but also to the vulnerable people that these jobs were meant for in the first place.

Furthermore, providing funding on a reimbursement basis does exactly the opposite of what these enterprises need – upfront capital that will allow them to invest in infrastructure and talent, both drivers of successful businesses. Nor does it give them the cash they desperately require to pay suppliers upfront and ensure that they can meet client demand. Burdensome bureaucratic requirements, only distract them from the day-to-day running of their enterprises.

Enterprises need patient capital in order to build their companies. They need patient capital for cash flow, for investment, and to underwrite business services. The way that patient capital is created is through blended structures that bring together public and private funding. Public funding can be used to de-risk investment capital. This allows for the offering of reasonably sized investments (USD 25,000-200,000) often needed by social enterprises but not offered by investors who need to deploy large amounts of capital with higher expected returns. It also allows for the creation of quasi equity structures such as recoverable grants to grow before breaking even and to become investment ready; patient loans with soft terms such as low interest rates, longer grace periods and repayments based on revenues and performance; or convertible debt and redeemable equity, instruments that recognize the need to transition enterprise ownership along the way.

For this to happen, we need to create the industry. And to create the industry, we need to work in partnership so that a value chain of support is created along the different stages of enterprise development. The fact that the enterprises in this study were able to generate 24 million euros in sales and create close to 1000 jobs for vulnerable people in one year reflects tremendous resilience and an entrepreneurial mindset on their part. The fact that they were able to survive the post EU funding period and are still having impact is also commendable.

But imagine where these entrepreneurs would be if they could rely on an ecosystem of private and public support that gives them the flexibility to innovate, the time to build market driven models, the opportunity to build sustainable jobs and income opportunities for the vulnerable, and the recognition that what they are doing is extremely important work but that they simply cannot do it alone. This would also speak volumes.

Nicole Etchart
NESsT Co-founder and Co-CEO

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ABOUT NESsT

NESsT has been working for 20 years to provide dignified employment to lift people out of poverty in emerging markets. NESsT achieves its mission by raising philanthropic capital to invest in and develop social enterprises that create employment and viable income opportunities for the poorest communities facing isolation, discrimination, lack of job skills and poor education. To date, NESsT has invited 187 social enterprises to enter its portfolio providing them with an average of four years of support and investing more than USD 15 million in capacity building and direct funding. Though this investment, NESsT has contributed to creating more than 49,500 dignified employment and sustainable income opportunities.

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