

## Chapter 14

# Portugal Inovação Social: An integrated approach for social innovation, Portugal

*Portugal Inovação Social acts as a market catalyst promoting the social investment sector in Portugal through the mobilisation of EU structural funds. Its funding programmes support innovative financing instruments tailored to the needs of both social enterprises and investors. This chapter describes the institution's objectives, rationale and activities. It also presents the challenges faced, the lessons learnt and the conditions for transferring this practice to other contexts.*

### Summary

In the past three years, Portuguese policy makers have placed social enterprises at the top of their agenda. A thorough process has been implemented to develop the social investment market, and initiatives have emerged on the ground to support social enterprises<sup>1</sup> as important vehicles for social innovation.

Learning from more mature markets, Portugal has created its own pathway to experimenting innovative ways of funding social innovation. To some extent, policy makers' discussions on social innovation have centred on how to finance it. The main outcome of these discussions has been a focus on creating the right incentives, mobilising private capital for social innovation and creating a new market.

In 2015, acting on the realisation that a central market was needed to improve social enterprises' access to finance, the Portuguese government created Portugal Inovação Social, a catalyst institution dedicated to social innovation and social investment. Reporting directly to the Presidency of the European Council of Ministers, Portugal Inovação Social harnessed EUR 150 million (euros) in European Union structural funds to create and promote an

investment market for Portuguese social enterprises transversally across different policy areas until 2020. Mobilising central funds to foster the social investment sector and create a suitable market infrastructure has positioned Portugal as a pioneer in the field, clearing the way for other countries to replicate such a model.

To tackle the diverse needs of social enterprises, Portugal Inovação Social allocates funds among four funding programmes:

1. **Capacity Building for Social Investment** enables social enterprises to access support from specialist providers.
2. **Partnerships for Impact** promotes venture philanthropy in Portugal through a match-funding system.
3. **Financing Instrument of Social Impact Bonds (SIBs)** promotes the importance of an outcome-based focus among public entities.
4. **Social Innovation Fund** mobilises capital and encourages investment in the social sector.
5. The Portuguese social investment ecosystem is still in its infancy; the time has come to implement policy actions to develop the market. The impact of the process will ultimately be measured by the capacity of market players – with a special focus on Portugal Inovação Social – to deliver the expected outcomes by 2020.

## Key facts

Portugal Inovação Social represents a milestone in the promotion of social investment in Portugal. Its creation in 2015 reflects the government's agenda of improving social enterprises' access to financial mechanisms. This new institution mobilises EUR 150 million in EU structural funds – especially the European Social Fund – under the scope of the “Portugal 2020” partnership agreement.

Portugal Inovação Social comprises four financing programmes, with specific targets and aims, which will operate between 2016 and 2020:

1. **Capacity Building for Social Investment:**
  - Funding available: approximately EUR 15 million
  - Expected launch date: March 2016
  - Objective: enable social enterprises to access investment-readiness support services from specialist providers through a voucher system
  - Maximum amount per social enterprise: EUR 50 000
2. **Partnerships for Impact:**
  - Funding available: approximately EUR 15 million
  - Launched in July 2016
  - Objective: promote venture philanthropy in Portugal through match-funding
  - Minimum amount per social enterprise: EUR 100 000
3. **Financing Instrument for Social Impact Bonds (SIBs)**
  - Funding available: approximately EUR 15 million
  - Launched in September 2016
  - Objective: promote an outcome-oriented culture within the public sector
  - Expected amount per deal: between EUR 350 000 and EUR 1 million

#### 4. Social Innovation Fund

- Funding available: approximately EUR 100 million
- Expected launch date: until the end of 2017
- Objective: mobilise private capital and encourage investment in the social sector through leverage and subordination incentives
- Approach: fund of funds, acting as a wholesaler

### Rationale

Portuguese social enterprises can traditionally access two types of capital: 1) philanthropic grants, which are usually provided by foundations, corporations and high net-worth individuals; and 2) bank loans with adjusted terms of reference, typically provided by a group of banks (especially co-operative and mutual savings banks) with stronger links to the social sector.

Social enterprises also finance their activities by providing services; most of these are paid for by the public sector through co-operation agreements, where the organisation provides a service on behalf of the government. The latest data available on the Social Economy Satellite Account suggest that the net unmet financial needs of social enterprises totalled EUR 768 million in 2010 (National Statistics Institute [INE] and António Sérgio Cooperative for the Social Economy [CASES], 2013), suggesting that the financial needs of Portuguese social enterprises were not being met by the available sources of capital before 2014.

To mitigate this unsustainable reality, in October 2013 the Calouste Gulbenkian Foundation, in partnership with IES Social Business School and Social Finance UK, launched Laboratório de Investimento Social (Social Investment Lab), a social finance intermediary and market-builder charged with devising financial and non-financial mechanisms to unlock capital for social enterprises.

Since its creation, the Lab has lobbied key decision-makers from the public, private and social sectors to include social enterprise and social investment as priority agenda items. It has produced research papers on the relevance and applicability of social investment in Portugal, and conducted pre-feasibility studies of social investment deals, fostering initial conversations with investors and local authorities.

In July 2014 the Calouste Gulbenkian Foundation, with the support of the Social Investment Lab and Social Finance UK, launched the Portuguese Social Investment Taskforce. Over the course of one year, the EU-funded Taskforce convened 21 members from the private, public, social, financial and academic sectors to discuss a strategy to develop the Portuguese social investment market. Their work culminated in a report (Portuguese Social Investment Taskforce, 2015) featuring five recommendations<sup>2</sup> paving the way for a national action plan on social investment. As a result of such advocacy efforts, in December 2014 the government announced the creation of Portugal Inovação Social, a catalyst institution aiming to promote social innovation and tackle the financing gap through innovative financing instruments.

While a consensus exists on the need for a catalyst to promote social investment in any given country, the typical method is to use unclaimed assets – an alternative with few prospects in Portugal. An attempt to replicate the mechanisms of Big Society Capital, the UK market champion, soon revealed that an early-stage market such as Portugal's required

a blended wholesaler-retailer approach. Hence, policy makers mobilised EUR 150 million in EU structural funds to create Portugal Inovação Social, the country's flagship initiative for using public policy to promote social enterprise.

## Objectives

Portugal Inovação Social aims to promote social innovation and tackle the financing mismatch between supply and demand in the social sector, by providing innovative financing solutions targeting the needs and concerns of both social enterprises and investors. Specifically, Portugal Inovação Social aims to:

**Improve the competitiveness of social enterprises.** Social enterprises often have a suboptimal organisational structure, owing to limited funds and a pressure to allocate existing financing to operations. This situation leads to low efficiency and prevents them from attracting talent to the sector. Portugal Inovação Social counters this tendency by considering human resources and overheads as eligible costs. Through its capacity-building programme, it further invests in developing social enterprises' workforce and organisational structure, to ensure investment-readiness and guarantee sustainable relations with investors.

**Promote the growth of projects with proven intervention and business models.** A financing gap exists in Portugal with respect to supporting social enterprises at two developmental stages: those whose business models have been tested and need further strengthening (Stage 2), and those whose business models have been strengthened and are therefore ready to scale (Stage 3; for a description of the different stages, see European Commission, 2016). Over its four-year course (2016-20), Portugal Inovação Social will provide funding instruments targeting social enterprises at both stages of development.

**Create evidence and inform public policy decisions.** Despite the large number of social enterprises and interventions, the limited funds to date have hampered a culture based on evidence creation. To promote such a culture, improve the quality of interventions in the long run and inform public policy decisions, Portugal Inovação Social try to foster the independent and scientific evaluation processes required by SIBs.

**Attract new players to the market.** As a way of closing the current financing gap, Portugal Inovação Social intends to attract new market players (i.e. venture capitalists and private equity funds) to the sector, using the Social Innovation Fund as a wholesale fund.

**Promote an outcome-based culture in the public sector.** Service provision represents approximately 40% of social enterprises' annual income (INE and CASES, 2013). Changing contracting methods to favour competitive procurement bids will pressure social enterprises to demonstrate: 1) their managerial capacity; 2) evidence of achieving outcomes and impact; and 3) their overall efficiency in delivering the services. Acting as an outcome payer under the SIB programme, Portugal Inovação Social creates evidence and helps demystify the concept, while laying the groundwork for the public sector to adopt an outcome-based culture in coming years.

**Promote the development of priority geographic areas.** Portugal's regional development faces strong inequalities. Given its central role as the country's capital and its high concentration of people, services and social enterprises, Lisbon absorbs the bulk of available funding. To counter this trend and encourage social enterprises to scale in less developed regions, Portugal Inovação Social's programmes will prioritise interventions in the following regions: North, Center, and Alentejo.

## Activities

Portugal Inovação Social proposes four funding programmes, featuring distinct objectives and structures tailored to social enterprises' different developmental stages. The programmes will share a common application process, based on calls for proposals issued at different periods between 2016 and 2020 (Portugal Inovação Social, 2016).

### 1. Capacity Building for Social Investment

Through its capacity building programmes, Portugal Inovação Social aims to ensure that social enterprises can access the support services necessary to prepare them for investment, and thus grow and expand their valuable work most effectively. As a catalyst entity, Portugal Inovação Social is using this programme to level the playing field among social and commercial enterprises, removing the barriers encountered by social enterprises in accessing specialist services.

Through a voucher system, Portugal Inovação Social will provide grants (up to a maximum of EUR 50 000) to social enterprises, enabling them to access support from specialist providers in areas such as financial management, business modelling, impact measurement, leadership and governance. This programme has available funding of EUR 15 million, and is expected to reach between 250 and 500 social enterprises by 2020.

### 2. Partnerships for Impact

Through this programme, Portugal Inovação Social matches the funds provided by philanthropic donors to promote venture philanthropy in the country. The programme aims both to create incentives for philanthropic capital to be invested over the long term and linked to outcomes, as well as instil a greater focus on investment readiness.

Under this programme, Portugal Inovação Social will match 50% of the amount committed by philanthropic organisations, with a minimum match of EUR 50 000. To be eligible for this programme, organisations must adopt a venture philanthropy-based approach: they must commit to providing both financial and non-financial support to social enterprises for at least three years, thereby ensuring that grantees become more sustainable and effective. The available funding for this programme is EUR 15 million.

### 3. Financing Instrument for SIBs

By acting as the direct outcome payer rather than as an investor, Portugal Inovação Social removes an existing bottleneck in SIB development – namely, convincing traditionally output-focused public sector commissioners to shift their commissioning towards outcomes.<sup>3</sup> This programme aims to develop innovative solutions to social issues, as a means of encouraging public entities to focus on outcomes.

Portugal Inovação Social will use this instrument to finance local and central governments interested in developing SIBs. This facility is designed to improve the financial viability of early SIBs and provide incentives for local government commissioners to pay for outcomes. This instrument has available funding of EUR 15 million; it is expected to result in around 20-25 SIBs by 2020.

### 4. Social Innovation Fund

Portugal Inovação Social will launch a wholesale fund that will co-invest in Portuguese social enterprises and social investment products with a demonstrated potential to generate social and financial returns. The aim is to mobilise capital and encourage investment in the social sector. Acting as a cornerstone wholesale investor, Portugal Inovação Social will provide favourable terms and conditions to capital holders wishing

to create retail structures to fund social enterprises. This fund of funds will adopt two mechanisms: debt and equity/quasi-equity. The debt mechanism will mostly fund innovation in more mature social enterprises by providing guarantees to co-investors, thereby improving the products' risk profile and allowing banks to lend to social enterprises on more favourable terms. The equity/quasi-equity mechanism will use asymmetric risk and return favourable to private co-investors to improve the terms for social investors and business angels keen to fund the growth and consolidation of social enterprises. This programme has available funding of approximately EUR 100 million.

The four programmes established by Portugal Inovação Social are aligned with social enterprises' developmental cycle, namely: 1) focus on the problem and devise a solution; 2) validate a business model; 3) ensure growth; and 4) disseminate the initiative. Where market insufficiencies exist, the most appropriate programme for each stage is as follows:

- Capacity Building for Social Investment: Stages 1 and 2
- Partnerships for Impact: Stage 2
- Financing Instrument for SIBs: Stages 2 and 3
- Social Innovation Fund: Stages 3 and 4.

The programmes are synergistic: a social enterprise that benefitted from the Capacity building or Partnerships for impact programme, for example, is likely to be a more robust candidate for the Social Innovation Fund.

By acting across a social enterprise's different stages of development, Portugal Inovação Social's role shifts from participating directly in the market to contributing indirectly to its development. This constant adaptation is essential for Portugal Inovação Social's to meet its mission of answering social enterprises' specific needs and filling market gaps.

## Challenges encountered and impact

The Portuguese social investment ecosystem is still in its infancy. However, the design of Portugal Inovação Social started well before its formal launch in 2015: indeed, the context and needs of social enterprises were studied in depth to maximise the chances of successful implementation. Table 14.1. shows an analysis of the strengths, weaknesses, opportunities and threats (SWOT) of Portugal Inovação Social.

Table 14.1. **SWOT analysis of Portugal Inovação Social**

Strengths	Weaknesses
<ul style="list-style-type: none"> <li>● Diverse funding programmes, meeting the needs of social enterprises at all stages of development</li> <li>● Depending on the programme, the funding conditions involved (whether for social enterprises or investors) are aligned and provide incentives for sustainable development of the market</li> <li>● Strong political endorsement, regardless of the partisan structure in place (smooth transition between different governments)</li> </ul>	<ul style="list-style-type: none"> <li>● Relatively short time span to extract lessons from the market and adapt programmes if necessary</li> <li>● Social enterprises marked by a predominantly weak social impact measurement culture, hampering both initial selection and continuous performance management</li> <li>● Under-developed evaluator market, particularly important for the Financing instrument for SIBs</li> </ul>
Opportunities	Threats
<ul style="list-style-type: none"> <li>● Strengthening the existing pipeline of social enterprises in Portugal by promoting scale and growth</li> <li>● Fostering a culture focusing on robust impact measurement, where social enterprises and social investors' aims are aligned</li> <li>● Strengthening market players by fostering competition to attract new players</li> <li>● Attracting new social investors by developing market intelligence and case studies</li> </ul>	<ul style="list-style-type: none"> <li>● Possible dependency by market stakeholders on the market champion</li> <li>● Manage transition period and sustainability post-2020</li> </ul>



## Challenges

Various challenges linked to each funding programme have been observed:

### 1. Capacity Building for Social Investment

One of the main challenges for the capacity building programme is the timid representation of specialist providers in the Portuguese market, owing to social enterprises' inability to pay for their services. At an initial stage, Portugal Inovação Social expects the few existing market players to comprise the bulk of specialist providers. In the medium term, however, the funding programme's incentives are projected to attract new providers wishing to explore capacity building support for social enterprises as a new business stream. An additional challenge is to ensure that capacity building programmes have a lasting impact. Portugal Inovação Social has struggled to find the right incentives to guarantee knowledge and skill transfer between specialist providers and social organisations.

### 2. Partnerships for Impact

While this programme is expected to expand available funding, one of the main challenges pertains to the initial cultural shift required to institute effective non-financial relationships between philanthropic organisations and social enterprises. Another challenge is that philanthropic sources in Portugal traditionally have annual budgets, whereas this programme requires multi-annual support.

### 3. Financing Instrument for SIBs

By paying for outcomes, the Financing Instrument for SIBs removes the main barrier to SIB development. However, the fact that local or central governments are not paying for outcomes might result in less buy-in and accountability on their part. To mitigate this risk, Portugal Inovação Social makes it mandatory for them to participate in the SIB partnership, as well as engage in contract and project management. Future plans involve blending outcome payments by the Financing Instrument for SIBs with top-ups from local and central governments.

### 4. Social Innovation Fund

One of the main expected challenges in implementing the Social Innovation Fund relates to the amount of bureaucracy and conditions for receiving EU structural funds, which may test Portugal Inovação Social capacity to preserve the social aims underlying its social investment instruments.

## Impact

Given the early stage of Portugal Inovação Social, whose first programmes – Partnerships for Impact and the Financing Instrument for SIBs – were launched in summer 2016, no robust social impact can yet be assessed. Nevertheless, as the market catalyst for improving access to finance, Portugal Inovação Social will need to live up to expectations. Since its inception in December 2014, Portugal Inovação Social's executive team has learnt how to mobilise and use EU structural funds for social investment, without losing sight of the institution's mission.

Portugal Inovação Social has both an opportunity and a challenge to create feedback loops on capital availability and allocation in the social investment market. Ultimately, its success as a catalyst for developing the market will be assessed by its capacity to adjust its programmes to the evolving needs of social enterprises over time.

## Lessons learnt and conditions for potential replicability

### Lessons learnt

If the overall vision for the Portuguese social investment ecosystem is to serve as a blueprint for other EU jurisdictions, learning from experience is a central element for ensuring replicability. So far, the key lessons learnt from the process are as follows:

**Government engagement is critical:** strong endorsement by policy makers is an absolute prerequisite for developing a robust social investment market. In its absence, systemic change will not be achieved; in its presence, social investment is a powerful tool to achieve impact at scale. In Portugal, strong support at the ministerial level since 2013 has played a critical role in ensuring the development of the social investment ecosystem, and specifically of Portugal Inovação Social. Government changes (namely, change of ministers responsible for social innovation) have not affected the social investment agenda.

**Create market champions:** even though Portugal Inovação Social is the catalyst institution, other players are also championing this nascent market. Calouste Gulbenkian Foundation has played a cornerstone role by simultaneously investing in market-building activities and specific transactions, helping move the market forward.

**Design a national action plan:** the Portuguese Social Investment Taskforce convened decision makers from the public, private and social sectors, and laid the foundations for the social investment ecosystem by issuing five key recommendations. Through this national action plan, Portugal Inovação Social was able to design funding programmes tailored to market needs. Each market player (investor, public sector representative or social enterprise) is fully cognisant of its role in implementing each recommendation.

**Quick wins are essential:** while they are generally not economically viable, pilot projects have an important role to play in testing new financial mechanisms and obtaining buy-in from key stakeholders. The market needs quick wins: as evidenced by the first SIB pilot in the municipality of Lisbon, launching a small-scale pilot will help create momentum and convince stakeholders of the concept's applicability.

### Conditions for potential replicability

When it comes to replicating the Portugal Inovação Social across other EU Member States, the use of EU structural funds can be a game-changer. New markets need incentives. Harnessing EU funding that is external to countries' national budgets can be a powerful tool for policy makers to experiment innovative ways of funding social innovation and proving their efficiency.

A key lesson from the government's all-inclusive approach to developing the market is that unless solutions balance top-down initiatives (such as Portugal Inovação Social and the Portuguese Social Investment Taskforce) with bottom-up approaches (such as the first SIB pilot in Lisbon), they run the risk of not being used by those for whom they were intended in the first place.

### Notes

1. For the purpose of this text, social enterprises refer to all types of entities, regardless of their legal status, that undertake activities yielding a measurable social impact of any form. To date, Portugal still has no legal framework for social enterprises.



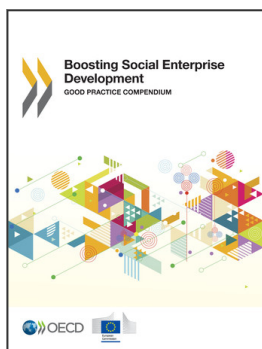
2. 1) Demand: strengthen social organisations through capacity building programmes; 2) supply: introduce financial instruments suited to social organisations and social innovation; 3) public sector: promote an outcomes-based culture in public services; 4) market intelligence: set up a knowledge and resource centre; and 5) intermediaries: promote specialist intermediaries to facilitate access to capital.
3. Outputs refer to directly measurable results as to how an activity touches the intended beneficiaries (e.g. number of beneficiaries), while outcomes correspond to the change arising from the lives of beneficiaries (GECES subgroup, 2014).

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## Further reading

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