__The Report of the Alternative Commission on Social Investment

After The Gold Rush

March 2015

The Alternative Commission on Social Investment

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"Big Society Capital is going to encourage charities and social enterprises to prove their business models – and then replicate them. Once they've proved that success in one area they'll be able – just as a business can – to seek investment for expansion into the wider region and into the country. This is a self-sustaining, independent market that's going to help build the big society." – David Cameron, April 2012

"We found market participants to be bullish about the future. From around £165 million of social investment deals made in 2011, our study shows that demand for social investment could rise to £286 million in 2012, and then to £750 million in 2015, finally reaching around £1 billion by 2016 if trends continue as forecast." – The First Billion, Boston Consulting Group report for Big Society Capital, April 2012

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Growing enthusiasm

The UK is a "world leader in social investment". Since the then Labour government backed the creation of a Social Investment Task Force in 2000, we have seen a steady build up of support from leading figures in the public, private and voluntary sectors for finance designed to achieve a combination of social and financial return.

During the 2000s, the UK Government created a series of state-backed funds and capacity-building programmes designed to support the development of the 'third sector' and the idea of a 'social investment market' emerged. Since April 2012, we have seen the creation of the world's first social investment wholesale finance institution, Big Society Capital, created to support a growing number of specialist intermediary and support organisations, and complemented by significant central government funding for incubation, acceleration and investment readiness.

But increasing disquiet

Yet unfortunately, there's a major disjuncture between the rhetoric of the 'first trillion of social impact investment' heralded in a recent G8 report[1] and the reality on the ground in the UK.

> *"There is a real feeling that the social investment community isn't listening to the people on the front line... There's a growing resentment, and a feeling that the social investment world is a London thing, with London-based intermediaries. There's a feeling it's a lot of people in London with clever ideas who are talking to each other."* **- Jonathan Jenkins, chief executive, Social Investment Business, quoted in Civil Society – 03/06/14**

> *"If you're talking about [investments of] less than £250,000, some part of the investment will always have to be grant… Small loans are expensive. They're expensive to originate, they're expensive to monitor. The default risk is always going to be reasonably high and there's a point at which the rate of interest is just inconsistent with the social mission of the enterprise... Likewise for the SIFIs, they say if we don't charge more than 10% that cannot possibly – in the absence of any grant support – be sustainable given the size of the loans. I think they're right too. So the market doesn't clear effectively. And so how do you square that?"*
> **– Nick O'Donohoe, chief executive, Big Society Capital, interview for Beanbags and Bullsh!t – 28/02/14**

The quotes above are not the dissenting voices of people on the margins of the emerging social investment industry – they're the thoughts of the bosses of the two largest organisations currently operating in the market, between them managing assets of around three quarters of a billion pounds.

While many individuals and organisations in the UK are successfully using finance to support social good, the idea of 'social investment' and the 'social investment market' are neither living up to the rhetoric of politicians and social investment leaders nor meeting the expectations of many charities and social enterprises.

The Alternative Commission on Social Investment was set up to ask why and to make some practical suggestions as to how things could be improved.

[1] http://www.socialimpactinvestment.org/reports/Impact%20Investment%20Report%20FINAL%5B3%5D.pdf

The Commission Secretariat
A Word from David Floyd

As a social entrepreneur running a small social enterprise in Walthamstow, East London, I have watched the development of the UK social investment market from several different angles:

> as a social entrepreneur thinking about whether and how these new models of investment were relevant to me and my business
> as a blogger giving my views on how the emerging market was affecting the social enterprise sector as a whole
> as a writer and researcher seeking to understand and explain the social investment market to others.

Since the mid-2000s, it has seemed to me that the models of social investment and the concept of 'social investment market' promoted initially by the previous Labour government, then by the Coalition were well intentioned but misconceived.

In theory, the idea of 'social investment' suggests the promise of finance which offers something different to what is on offer from banks or other mainstream investors. However, investee organisations still need to be profitable enough to take on finance from a Social Investment Finance Intermediary (SIFI) and repay it at a rate that enables SIFIs to at least break even themselves.

The idea that there are enough organisations underserved by our mainstream financial services to enable the creation of an entire new market to be met by socially motivated investors and for this all to still stack up financially seems too good to be true. That is because it is not true. As social entrepreneurs have known for decades, trying to run a viable business where the market fails is, by definition, a difficult trick to pull. The reality is, as Nick O'Donohoe says, that: "Most social investment requires subsidy, and subsidy should not be a dirty word." [2]

[2] http://iipcollaborative.org/lessons-learned-from-establishing-the-worlds-first-social-investment-bank/

Facing facts and taking action
The emerging realisation that social investment is not quite as magical as it may have initially appeared does not mean that it's wrong to try to use repayable finance to support social good. Social investment still has great potential to help us both to better use of the existing available resources to change the world for the better and to increase the resources available to this end.

However, if social investment is being talked about more than its actually happening; if it's subsidised by someone; or if it's not even a better deal for social enterprises than more conventional investment, then we need to face up to and admit these truths. If it's subsidised, for instance – whether it's the state, trusts and foundations or private individuals – it's important to be clear about the extent to which and why we're subsidising it. We need to know why we're favouring a subsidy for social investment over a more traditional subsidy to the social sector through a grant. The combination of significant government support and the expertise of growing numbers of talented, socially committed people to the idea of social investment means that we in the UK now have a window of opportunity to create a version of social investment in practice that is both socially useful and financially sensible.

I hope the Alternative Commission will be a contribution towards doing that.

David Floyd
Social Spider CIC
Alternative Commission Team

The Project

The Alternative Commission on Social Investment is an initiative designed to take stock, investigate what's wrong with the UK social investment market and to make some practical suggestions for how the market can be made relevant and useful to a wider range of charities, social enterprises and citizens working to bring about positive social change.

The five key underlying questions the Commission has addressed are:

1. What do social sector organisations want?
2. Can social investment, as currently conceived, meet that need?
3. What's social about social investment?
4. Who are social investors and what do they want?
5. What can we do to make social investment better?

A small Commission Team with experience in social enterprise and social investment in policy and practice developed the initiative, and carried out desk-based research and interviews both with those involved in the UK social investment market and with others with insights to offer on its development, whilst openly encouraging input from other interested parties.

The work of the Commission Team was guided by 14 Commissioners, all of whom have some interest and knowledge of social investment but many of whom offer experiences and perspectives beyond those of the current major stakeholders in the social investment market. We worked with partners to organise 9 roundtable events: some focused on specific countries and regions within the UK, others looking at particular topics. It total we talked to over 100 people in person and 20 more contributions through our online survey.

The Commission's work has been a wide-ranging participatory discussion. This report is not and does not claim to be a piece of quantitative research. This report does, however, seek to look at the UK social investment market more from the broad perspective of what Big Society Capital describe as 'Social Sector Organisations' rather than from the perspective of intermediaries and investors, whose viewpoint has often been the focus of other research reports in this field.

Clearly, there is not a single 'Social Sector Organisation Perspective'. Experience of the practical relevance of social investment funds will vary wildly, for instance, between a local social enterprise, just about breaking even with a turnover of £200,000 and a large national charity, delivering major public contracts with turnover over £20 milllion.

However, the Commission starts from looking broadly at what, based on available evidence, Social Sector Organisations might want or need – and then considers the extent to which the emerging social investment is succeeding in delivering that.

This is a different starting point from much of the voluminous research published over recent years on the development of both UK and international markets. But it is worth emphasising that everyone involved in writing this report is a supporter of social investment. We all want to see an increase in the effective use of finance to do good.

The report makes 10 key points and 50 recommendations in total. These are mixture of strategic and practical recommendations.

The Commissioners have been responsible for providing broad guidance and feedback to the Commission Team. They are a diverse group with a wide range of starting points and perspectives so neither the totality of the report nor all the recommendations necessarily represent their personal opinions or those of their organisations.

However, our Commissioners do agree that that the five key areas addressed in the recommendations are the right ones and that the direction of travel suggested by those recommendations is worth pursuing.

Commission Team:

David Floyd *(Social Spider CIC)*, Dan Gregory *(Common Capital)* and Nikki Wilson.

Commissioners:

Daniel Brewer *(Resonance)*, Martin Brookes, Ged Devlin *(Community Shares)*, Niamh Goggin *(Small Change - NI)*, Mike Harvey *(Candour Collaborations)*, Helen Heap *(Seebohm Hill)*, Katy Jones *(Clearly So)*, Vibeka Mair *(Responsible Investor)*, Ian Marr *(YMCA Scotland)*, Julia Morley *(Department of Accounting, LSE)*, Alex Nicholls (*Skoll Centre for Social Entrepreneurship)*, Holly Piper *(CAF Venturesome)*, Asheem Singh *(ACEVO)*, Sam Tarff *(Key Fund)*.

Section

1 What Do Social Sector Organisations Want?

8 Over the past decade and more, a number of different terms have been used to describe the 'loose and baggy monster'[1] of civil society, the social sector, third sector or VCSE (voluntary, community and social enterprise) organisations. Depending on your preferred term, your favoured definition and your own interpretation of that definition, the boundaries of 'the sector' are blurred and often contested.

But while we will look later in this report at 'segmenting the market', at this stage we are not favouring one particular term, definition or interpretation. Here, we are merely revisiting some of the most significant evidence which considers what a range of organisations in and around this space are looking for in terms of finance.

Some of this evidence is relatively unknown and perhaps should be heard more widely. Some is relatively well understood, at least within the sector itself and among policymakers. But often, crucial nuggets of evidence, critical caveats or slight subtleties have been forgotten or lost within a wider narrative or overtaken by events and announcements. Here, then, we reconsider the most important evidence we have and seek to succinctly summarise the key messages emerging below.

The Bank of England

Ten years ago, the Bank of England published its seminal *The Financing of Social Enterprise*, *A Special Report*, which spawned dozens of related reports over the following decade (each arguably less *special* than the last). In this, the first serious publication of its kind, the Bank revealed that demand "for debt finance among social enterprises is limited both by the availability of other, cheaper forms of funding such as grants, and by a cultural aversion to the risks associated with borrowing."[2] The Bank also suggested that there was "little demand for... conventional venture capital or business angel finance in the social enterprise sector".

Nevertheless, despite the "limitations on demand, there is evidence that social enterprises, particularly larger, more established organisations, use a range of external finance instruments supplied by banks and other lenders such as Community Development Finance Institutions." There was also "evidence of demand among social enterprises for some form of 'patient' finance, particularly at the start-up or expansion stages."

While this report is now a decade old, much of the above feels to even a casual observer of the social sector as instinctively still accurate. Does evidence gathered over the last decade tell us that the story has changed? While the supply of finance has grown, has the demand side of the market developed? Are social enterprises (SEs) increasingly looking to attract finance? Have policies and programmes realised latent demand? Has the type of finance sought by the social sector changed?

Government research

Since the Bank of England report, successive governments have championed the need for new policies to help social enterprises, voluntary and community organisations more easily access appropriate finance. In 2007, the University of Warwick Business School undertook the first serious government-backed direct comparison between access to finance for Small and Medium Sized Enterprises (SMEs) and SEs. This work was funded by the then Department of Trade and Industry (DTI) and supported by the then Office of the Third Sector.[3] The research concluded that when it came to accessing finance, there was:

> little evidence that social enterprises are either riskier or less well understood;
> no significant difference between social enterprises and mainstream businesses in the number that had been rejected;
> no significant difference between social enterprise and mainstream businesses in the amount of finance received, relative to that sought; and
> no significant differences in the loan margins paid by social enterprises and mainstream businesses.

The report also noted that social enterprises require relatively less collateral than mainstream businesses. These findings are particularly revealing given that evidence suggest that the mean annual turnover of SEs is "substantially lower and two-thirds of the average for SMEs", when one might expect smaller businesses to have greater difficulty in finding finance.

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[1] Kendall, Jeremy and Knapp, Martin R J. (1994) A loose and baggy monster: boundaries, definitions and typologies

[2] http://www.uk.coop/sites/storage/public/downloads/bank_of_england_the_financing_of_social_enterprises_0_0.pdf

[3] http://webarchive.nationalarchives.gov.uk/+/http:/www.cabinetoffice.gov.uk/third_sector/research_and_statistics/social_enterprise_research/access_finance.aspx

Then in 2011, the new government undertook further research. *Business Support for Social Enterprises* [4] concluded that "Finance issues recur as a major source of problems for SEs throughout the literature" but went on to say that "though delving more deeply reveals some inherent complexities within the sector, related to understanding and attitudes." The research then suggests that "the purposes for which external finance are sought were similar for SEs and SMEs" and "a similar proportion of SEs as SMEs had actively sought external finance in the previous six months (17 and 19 per cent respectively)". But somehow, finance was *seen* as a more important issue for social enterprises which may be "partly explained by the conflation of external finance and regular revenue funding by SEs". Even the report itself confuses the two, reporting at one point that the "most common form of finance was grant support".

[4] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/32229/12-566-business-support-for-social-enterprises-longitudinal.pdf

So the evidence from Government suggests that there has been an issue of sorts when it comes to the social sector accessing finance. But perhaps no more so than for 'conventional businesses' and part of the problem is linked to a lack of clarity between the sector's own appetite for finance and the pursuit of revenue funding and grants, which muddles the picture.

Social Enterprise UK

One of the most commonly heard quotes in the social investment field – and the cornerstone of evidence of the problem – is that "access to finance is the single biggest barrier faced by social enterprise". This is often attributed to Social Enterprise UK's bi-annual survey of social enterprises. 2011's *Fightback Britain's* [5] survey sample was drawn from SEUK members and related social enterprise networks and a dataset of 8,111 self-defining social enterprises. Over 800 responses were gathered (with Industrial and Provident Societies perhaps more strongly represented than the sector as a whole and CICs relatively underrepresented).

[5] http://www.socialenterprise.org.uk/uploads/editor/files/Publications/Fightback_Britain.pdf.

In this report, SEUK admits that for start-ups the "first four barriers arguably read like the worry-sheet of any new business start-up."[6] But for longer-term sustainability, "Access to finance and cash flow problems still dominate the concerns of social enterprise – 44% of respondents are still hampered by the availability and affordability of finance." This compares to SMEs who "rank the availability of finance as only their sixth greatest obstacle to success." Crucially, however, it should be noted that "affordability" is part of what many social enterprises reported as a problem whereas for other SMEs, the question was one only of 'availability'.

[6] Ibid.

Fightback Britain then goes on to explore this issue in more detail and reports that "the most common type of finance applied for was a development grant, sought by 61% of those looking for finance." This echoes the BIS research and how the conflation of finance and funding which may serve to disproportionately emphasise access to finance as a more urgent issue for social enterprise than if only repayable finance was considered. The report also suggested that "very few social enterprises sought to issue equity… 4%", whereas the Government report elsewhere that "less than 3%" of SMEs seek equity finance. The report also reveals that the median amount of finance sought was close to £100,000.

Two years later, SEUK published *The People's Business*. This time, 878 responses made up the survey from a potential sample of 9,024 and with a similar composition to previously. Again, a significant percentage – 39% – "cited access to finance as the single largest barrier to their growth and sustainability – the most common barrier experienced." Indeed, 48% of social enterprises had "sought to raise external finance in the past 12 months. twice the proportion of SMEs" but again, grants were included in the scope of what was meant by finance. Again, relatively small amounts of finance were sought with the median amount at £58,000.

Lyon and Baldock

In 2014, Professor Fergus Lyon and Rob Baldock looked in greater detail at the SEUK evidence, delving further behind the headlines.[7] They concluded that 65% of social enterprises are simply not interested in repayable finance and only " 15 percent of social enterprises are seeking loan finance, with most of these borrowing from high street banks. Only one in five borrowers or 3.6 percent of all social enterprises are approaching social investors". The research also reported that the cost of finance is the most significant deterrent for social enterprises.

[7] http://www.birmingham.ac.uk/generic/tsrc/documents/tsrc/working-papers/working-paper-124.pdf

Meanwhile, the report says that "Social enterprises appear to be more successful than other types of small business in getting finance" and "those in the five to ten year age group were more likely to seek finance. This differs from other SMEs where there is greater likelihood of seeking finance in the first five years." Furthermore, while there has been some consensus in recent years in the social investment arena that one of the key problems is a lack of access to unsecured lending, Lyon reports that already "just under 60 percent of borrowers have unsecured finance with commercial banks providing unsecured lending to just under half of their customers."

So the SEUK reports and a closer look at the surveys reinforce the picture from Government. Access to finance is a problem but affordability is one of the main issues and what many social enterprises are seeking is grants.

Investment Readiness in the UK

Other research and surveys have been undertaken in recent years to help understand the social sector's demand for finance. One of the most significant pieces of research was *Investment Readiness* in the UK, undertaken by ClearlySo and NPC for the Big Lottery Fund. A survey was sent out to 7,420 UK " voluntary and community organisations and social enterprises drawn from databases held by the Big Lottery Fund and ClearlySo" and 1,255 organisations completed the survey. The authors admit that there is "still likely to be selection in terms of what organisations are included on the Big Lottery Fund's and ClearlySo's databases and some self-selection in terms of which type of organisations were more likely to complete the survey".

This research concluded that "Just under half of those surveyed are not interested in investment." For those who were, the "big demand is for longer-term loans... from asset backed, mortgage type lending through to more speculative risk capital" and survey respondents were "primarily interested in investment between £10,000 and £100,000."

Many of those seeking investment had been successful and were content with the terms of the investment with "three quarters (75%) reporting that they felt the terms were appropriate". Echoing Lyon's observations about unsecured lending, the research reports that almost half had to provide security – suggesting that half did not.

Meanwhile, for those who had failed to attract finance, the "principal use of investment would have been for 'scaling up'. This suggests there are significant problems for organisations wishing to access riskier, scarcer, growth capital...". Also echoing SEUK research, the report points out that a significant number of VCSE organisations were indeed seeking to issue equity, above wider SME averages.

Figure 1, p. 12-13

IVAR for the Charity Commission

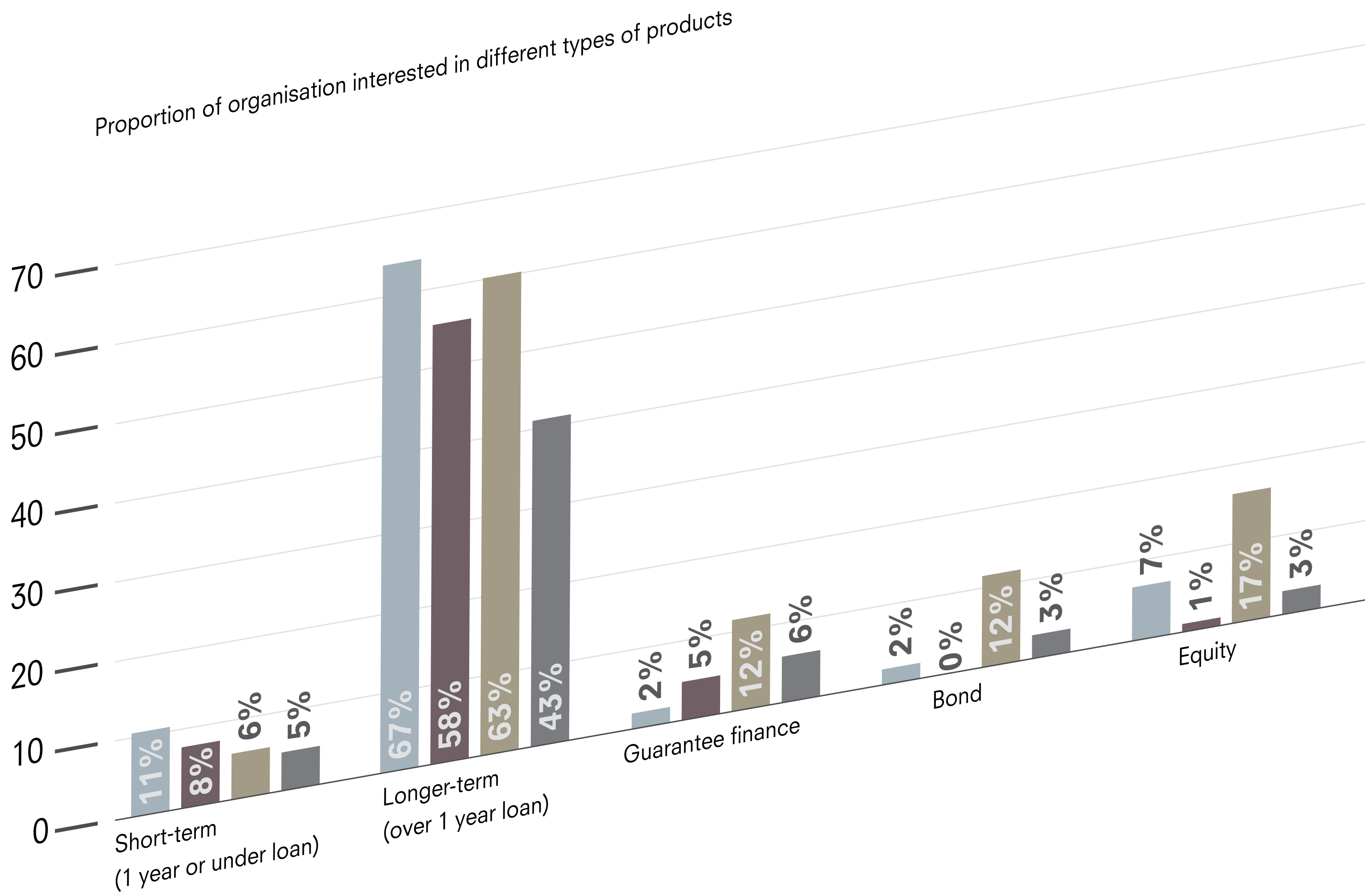
In March 2013, the Institute for Voluntary Action Research published a report for the Charity Commission (for England and Wales) which was based on study findings are drawn from interviews, meetings and facilitated group discussions with 25 charities that have received social investment (chief officers and trustees) as well as investors and intermediaries. The study found charities sought "small loans of £5-25,000 as well, and patient, evergreen equity finance. Study participants noted that risk capital at low interest rates is necessary for tackling difficult social issues..."[8]

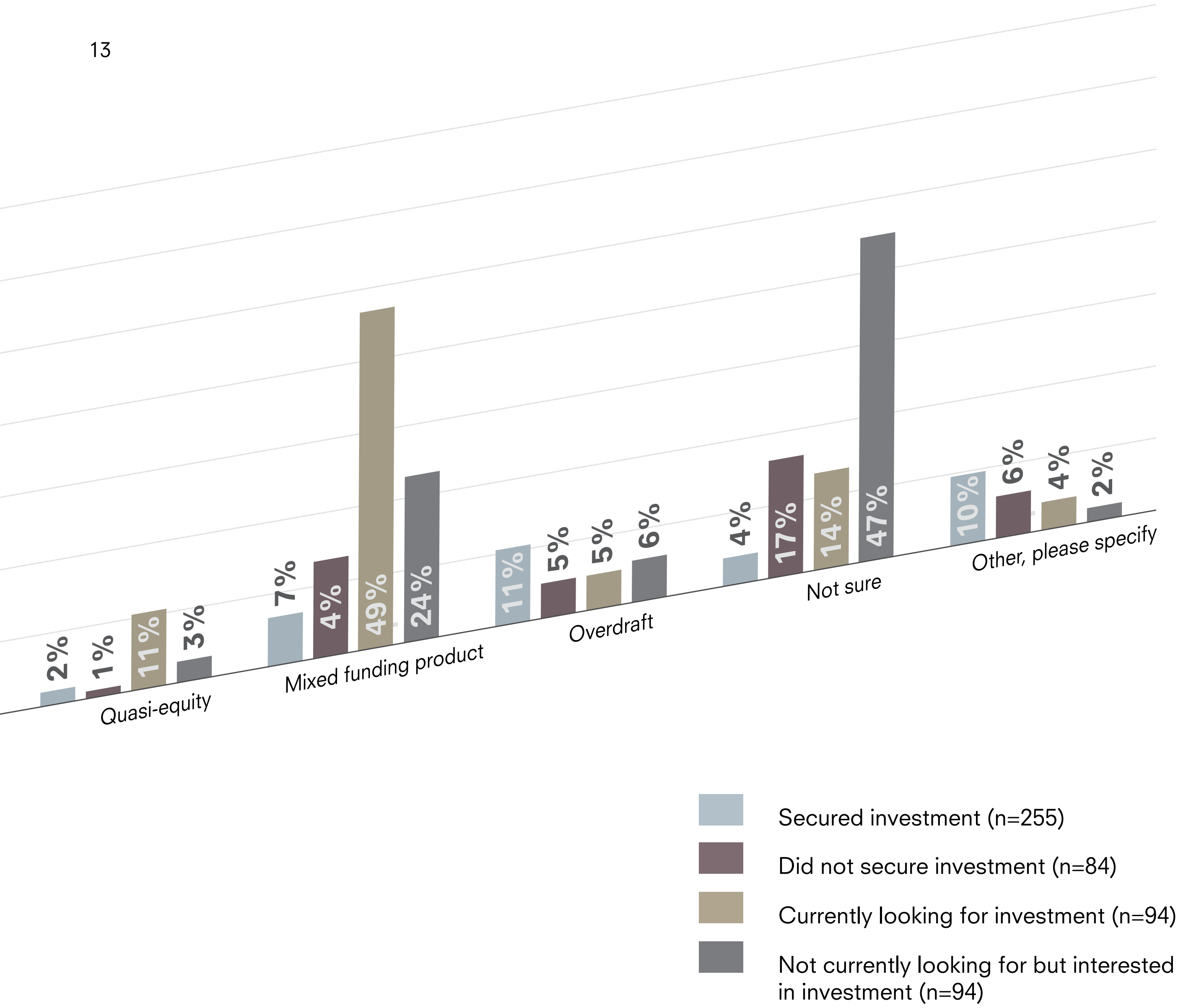
[8] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/284706/social_investment.pdf

Section

1

Figure 1: The type of finance that organisations are interested in securing




2%
1%
11%
3%
Quasi-equity
7%
4%
49%
24%
Mixed funding product
11%
5%
5%
6%
Overdraft
4%
17%
14%
47%
Not sure
10%
6%
4%
2%
Other, please specify
Secured investment (n=255)
Did not secure investment (n=84)
Currently looking for investment (n=94)
Not currently looking for but interested in investment (n=94)

CAF's In Demand

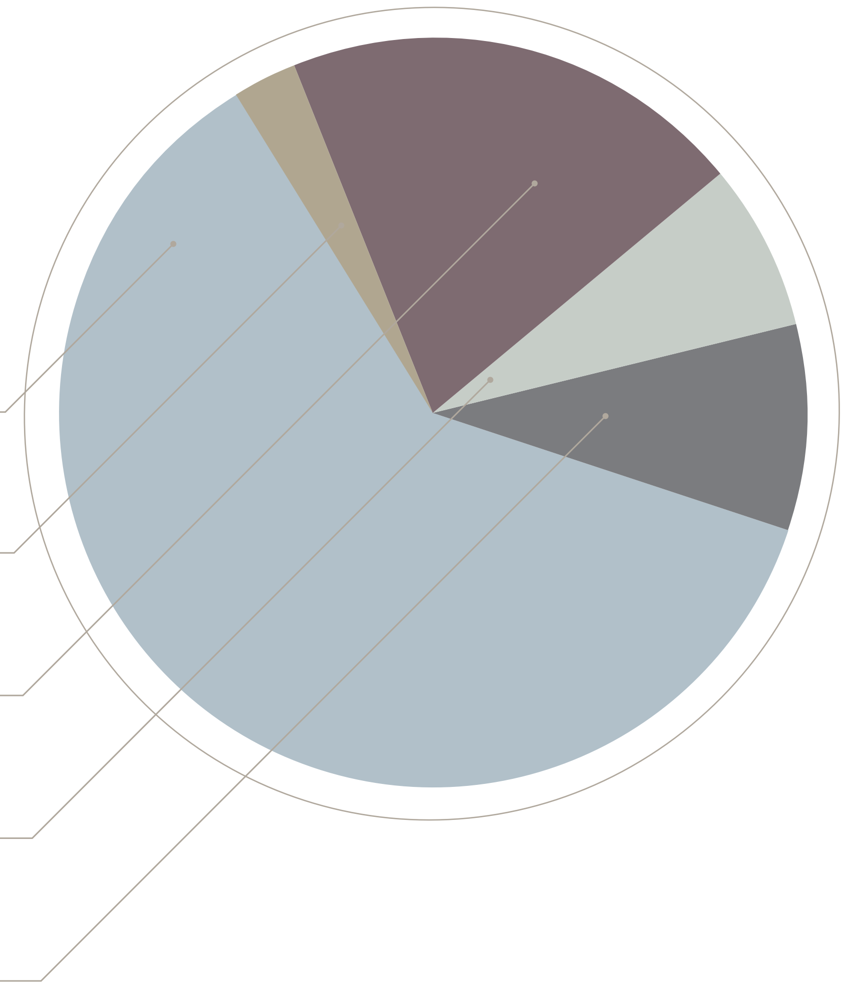
A more recent piece of research was undertaken by CAF in March 2014[9]. This was based on a quantitative online survey of 252 UK registered charities, although only those with a turnover above £60,000 were included. *In Demand* concluded that "61% of charities with an annual income of £60,000 or more have no experience of taking out repayable finance and no expectation of doing so in the future" and this is stronger among larger charities. The report argues that "Borrowing intentions over the next five years indicate a strong demand for unsecured products". It also highlights unmet demand for "affordable risk capital, available for borrowing at lower amounts"[10] with the majority of charities suggesting any loans they sought would be less than £250,000".

[9] https://www.cafonline.org/pdf/In_Demand_0314.pdf

[10] Ibid.

Market Overview

Base: All Screened (1,811)



61%
Somewhat unlikely/unlikely to take it out in the future

3%
Have repayable finance experience

20%
Have sought repayable finance before

7%
Very/somewhat likely to take repayable finance our in the future

9%
Neither likely nor unlikely to take repayable finance out in the future

Sunley and Pinch

Recent research by Sunley and Pinch revisits a range of evidence from the 2003 Bank of England report onwards and combines this with interviews with social enterprises "identified from local lists, associations and internet-based publicity material and through 'snowballing' and recommendations from interviewees... Most were small enterprises but in each location we also made sure that we interviewed several larger operations."

The research "addresses the degree to which the funding of SEs has shifted towards a greater reliance on loans … In general, it finds a very limited degree of change." [11] From the sample, 75% had never borrowed, most "were not aware of any equity schemes or quasi-equity schemes and dismissed the relevance of equity to their slow growth, small surplus and social value strategies".

[11] Sunley and pinch

But while demand was limited, many believed that finance could be on offer if sought. Only "two respondents expressed the view that banks do not understand" social enterprise and many believed that "they would not have great difficulty in acquiring a loan" should they want to pursue such an approach. Half of those who borrowed did so from commercial banks.

Durham University

In February 2015, Durham University published a report called "How willing are third sector organisations to borrow money?" This was based on three large surveys in the North of England by the Northern Rock Foundation Third Sector Trends study, where over 2,000 organisations were surveyed. The research suggested that in the third sector, conceptions of money are rather more cluttered than in other sectors with less clear distinctions "between 'given money', 'earned money' and 'borrowed money'." [12]

[12] Durham university

Only 14% of respondents reported that "borrowing money is at least of some importance to them as an organisation", that about 16% of TSOs have a 'tangible interest' in borrowing money, and that only 4% have actually borrowed money in the last two years." This falls to just 1% of micro and small TSOs. The survey in Cumbria went into greater detail about the terms of borrowing, revealing that around 80% of those surveyed stated that interest rates are "very important when considering loans".

NCVO

Of course, grant-maker, investor and social enterprise network member surveys and academic studies only tell us part of the story. Surveys often paint a subjective picture, survey samples may not be representative and questions can be loaded or leading. In order to look at the wider social sector and to use hard data, our first stop is inevitably the Civil Society Almanac, produced by the National Council for Voluntary Organisations – and based on statutory returns and Charity Commission data (for England and Wales). In their own reports, Cabinet Office have pointed out the single most significant statistic from NCVO which is worth repeating again here - charities have £3.5 billion of loan finance, of which 82% is provided by commercial lenders.[13]

[13] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/205295/Social_Investment_Strategy_Update_2013.pdf

Charity Bank

Yet these NCVO figures can only tell us what is already being borrowed at a sector-wide level. Charity Bank research delves deeper at the charity sector and looks at how this breaks down at, for example, a regional level and across different sizes of organisation.

This research, albeit from 2007/08 suggests that 77% of credit is taken up "by organisations with turnovers of greater than £1 million".[14] The evaluation of Charity Bank in the North reports that "On average the gearing ratio for general charities is 15 per cent, but again, higher for large and major charities. For charities with turnovers of less than £1 million the gearing ratio is less than 10 percent."[15] Charity Bank's research in the north of England undertook an analysis of a sample of 522 charity accounts from 2009-10 located in Yorkshire and the North East with an annual income of more than £500,000. It found that only 69 organisations or 13% had borrowings.

Following this research, in September 2013, Charity Bank also released the results of a survey on bank lending to charities.[16] In summary, it reports that:

> almost 30% of charities who approached a bank had their application turned down;
> 23% of potential borrowers were put off as they thought it was "too complicated";
> 46% of all respondents were put off by cost; and
> 31% who approached high street banks for a loan ended up taking one.

These figures can be, more or less, compared to bank lending to mainstream business. BDRC Continental's SME finance monitor tracks lending trends over time. While the numbers fluctuate from quarter to quarter, recent figures suggest that:

> 45% of businesses were initially declined a new loan;
> nearly 40% of potential borrowers were put off by the process and the hassle;
> somewhere between 20% and 30% thought it would be too costly; and
> around 60% ended up with a loan.

When taken together, these results suggest that charities appear to be rejected by banks less frequently than mainstream SMEs. They also find the process of negotiating with the bank less off-putting than wider businesses do. But charities do remain less likely to end up with what they want from the banks. It seems that the critical factor here is that around 40% of charities were offered a loan but did not take it up, and the most significant reason appears to be the cost of capital.

Seebohm Hill

Helen Heap at Seebohm Hill also puts emphasis on the need to explore hard data rather than rely on subjective surveys. Her research is based on "publicly available financial and other data" including regional social enterprise network member directories, directory of co-operatives, from Co-operatives UK, CIC regulator, Charity Commission, Companies House and more. Helen emphasises how "the inclusion of large, well-established charities, registered social landlords and public sector spin-outs within the membership and survey data of the networks can obscure and perhaps even distort the underlying picture and will lead to erroneous conclusions being drawn if great care is not taken in interpreting results."

Helen's research points out that "49% of the social enterprise group in the North West (NW) sample where income data is available have annual turnover of less than £50,000"[17] and only "14% of the NW social enterprise sample have annual income of £250,000 or more." Annual income of around £36,000 is the median for the NW sample excluding charities, Registered Social Landlords (RSLs) and public sector spin-outs. This research backs up similar findings from Investment Readiness in the UK and the SEUK data that most organisations looking for finance will be seeking tens, rather than hundreds of thousands of pounds.

[14] **Table courtesy of:** http://www.charitybank.org/sites/default/files/pdf/Final%20SHU%20CBN%20Evalution%20Report%202010-11.pdf

[15] Ibid.

[16] http://www.charitybank.org/news/69-charities-are-unsuccessful-accessing-loans-high-street-banks

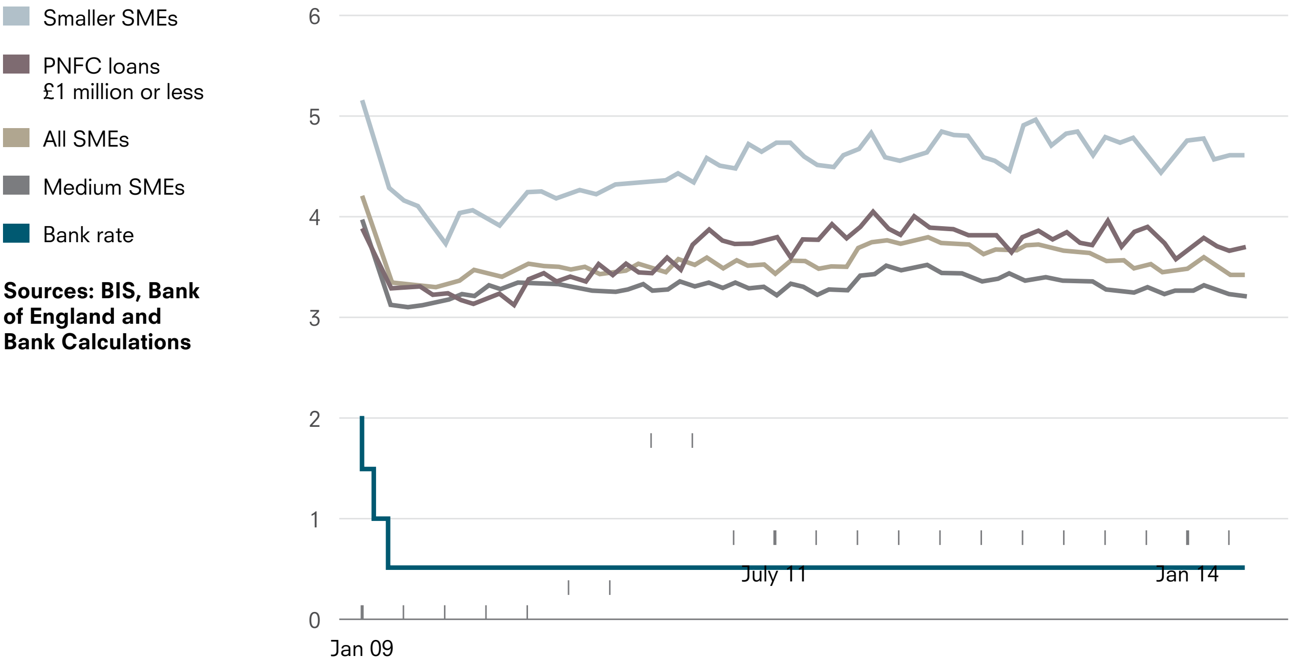
[17] http://www.seebohmhill.com/images/documents/North_West_Social_Enterprise_Analysis.pdf

Bank of England lending data

Beyond the appetite for investment, the products (debt or equity, for example) and the size, we also need to consider the *terms* of the investment on offer. The Bank of England issues quarterly lending data, which reveals the average cost of capital for SME borrowers, perhaps a useful guide for illustrating what any business may be willing to pay to access finance. *Trends in Lending*[18] from July 2014 presents the Bank of England's "assessment of the latest trends in lending to the UK economy" and "draws mainly on long-established official data sources."

[18] http://www.bankofengland.co.uk/publications/Documents/other/monetary/trendsjuly14.pdf

Figure 3 – Indicative Interest Rates on Lending to SME's
In %



Sources: BIS, Bank of England and Bank Calculations

The Bank figures suggest that the cost of borrowing for SMEs is under 4% for all SMEs and under 5% for smaller SMEs. The Bank does not hold data specific to social enterprises.

Regional and country variations

Several observers beyond London have argued that there is significant variation in demand for finance outside the capital. The Charity Bank in the North evaluation, the Northern Rock surveys and the Seebohm Hill research are focused on specific areas within the wider United Kingdom. Other research has at times also considered the scope for geographical variations within the demand for finance. For instance, Colin Stutt's *Finance for the Social Economy in Northern Ireland* was based on telephone survey of 176 social economy organisations in Northern Ireland. The report concluded that "established social economy organisations with a banking track record receive banking and other commercial financial services on a basis which is possibly more favourable to that which comparable for profit businesses receive in Northern Ireland."[19] It also described the "the absence of a general market failure in relation to established social economy organisations".

[19] http://www.colinstutt.com/Finance_for_the_Social_Economy_in_Northern_Ireland__-_final_report..pdf

These findings and others echo the wider, national research explored above. So perhaps there is less geographical difference in the needs and wants of social enterprises between London and the rest of the UK than some perceive. Instead, we have an issue about how the needs and wants of the sector as a whole are being distorted or even misrepresented by policymakers, advocates of social investment and other influencers based in London.

It seems from the evidence above that the views and perspectives expressed by a number of commentators in the North of England, Scotland or Northern Ireland, for instance, quite accurately reflect the needs and wants of the social sector while meanwhile, policymakers and fund managers in London over the past decade have pursued an agenda which reflects a rather selective reading of the evidence. Indeed Sir Ronald Cohen, a central advocate of social investment over the years has argued for a "Build it and they will come!" approach which is, if nothing else, a policy based on belief rather than evidence. Perhaps, then, it is less the case that practice in London is disconnected from the experience of the rest of the UK and rather more, that the ideas of Westminster and the City of London are disconnected from the evidence.

Segmentation

As Colin Stutt wrote in 2004 "There is a danger in writing about the social economy of making generalisations and seeking to force a single conceptual structure on such a diverse sector."[20] So of course, while the evidence above suggests that for the sector as a whole, access to finance is rather less of an issue than the scale of rhetoric and policy over the past decade might suggest, this does not mean that certain corners of the social sector do not suffer from particular problems and encounter specific market failures. One particular issue seems to be patient capital in relatively small amounts, which doesn't come in the form of equity and may not even come in the form of a conventional loan. There may be other, more localised issues, specific to certain geographies, sizes of organisation, income generation model, maturity, legal form, etc.

[20] http://www.colinstutt.com/Finance_for_the_Social_Economy_in_Northern_Ireland__-_final_report..pdf

As Venturesome said in 2008, "Venturesome has seen a growing number of additional voices calling for significant steps to be taken to build a strong social investment market. This welcome advocacy appears, however, to be accompanied by confusion regarding the different models of civil society organisations, their social impact and expected financial returns. Clarity is needed. These organisational models have varying financial needs. A supply of capital, comprising a range of financial instruments, is required across this broad spectrum of demand."[21]

[21] https://www.cafonline.org/pdf/Venturesome_FinancingCivilSociety_1806091.pdf

***How* do social sector organisations want finance?**

Beyond the question of *what* type of finance social sector organisations might seek is a question of *how*. While this report is looking primarily at the what, in order to emphasise evidence which may have been rather neglected and ignored, we should also give some consideration to how finance is sought. A range of evidence over the years provides a somewhat unsurprising picture that social sector organisations would prefer a more easily navigable route to finance than a baffling and time-consuming one. This has been reinforced in the roundtables held as a part of the work of the Alternative Commission, at which delegates have called for:

> a market that is much easier to navigate
> clearer, simpler, less arduous application processes
> quicker decision making
> greater transparency from investors up front about
> *> what they will and won't fund*
> *> where the money goes*
> *> the terms of investment*
> *> how to present a case for investment*
> *> what the application process will involve*

Conclusion

Fergus Lyon argues that there are "large gaps in our understanding about the demand for social investment. As much of the rest of the world looks to the UK experience of social investment, there is a need to show how the demand for social investment is based on clear evidence."

In this context, it is worth reviewing the evidence we do have, which, while flawed and limited, can help us reflect upon the rationale for various policies, programmes and developments in social investment over the last decade. Of course, broad evidence, surveys and averages do not necessarily reflect how the economic landscape is experienced by individual social enterprises on the ground. Also, while the evidence does not seem to bear this out, some observers suggest that the landscape has changed dramatically in the last few years.

With these admissions, we can nevertheless state that the evidence we do have suggests:

> There is little, if any, evidence of a *generic* social sector problem with access to finance.

> Most social sector organisations aren't interested in finance. Others, mainly large organisations, borrow billions already. Some social sector organisations encounter similar problems in accessing finance to any other businesses, even though they are on average, smaller.

> Those who do want loans are relatively successful in getting offers of finance from banks, even unsecured. They are also more likely to access equity investment than other SMEs. Social investors are somewhat a sideshow.

> The cost of capital is a turn-off - even when banks are offering an interest rate under 5%.

> Demand for finance should not be considered *en masse* but segmented into smaller groups by, for example, small and large, asset rich and light, spin-outs and start-ups, etc.

> There may be some unmet demand in certain segments of the market, such as for cheap, risky, long term growth finance in the tens – but not hundreds – of thousands.

> Both researchers and social sector organisations are conflating and potentially confusing capital / finance / investment with revenue / funding / income.

> In practice, there is probably not a geographical gulf between 'London vs. the regions', more an ideological gulf between 'Westminster and the City vs. the evidence'.

> Social sector organisations would, unsurprisingly, prefer a more easily navigable route to finance than a baffling and time-consuming one.

Section What's Social About Social Investment?

2A Social investment as currently conceived

20

A brief history

"Social Investment" as a term has evolved over time, both in popularity and meaning. Indeed some have argued that uncertainty and differing interpretations of the term are at least partly responsible for problems in the perceived effectiveness of the "social investment market" today. Here, we briefly explore the meaning of these two terms and what they have come to represent.

Tony Blair's Third Way guru Anthony Giddens first coined the expression "the social investment state" in 1998. Giddens has subsequently outlined how this was intended to refer to "a system which invests in preventative measures, and measures which combat inequality."

Later in Germany, in 2006, the Centre for Social Investment was created within Heidelberg University and focused on "the performance of non-profit-organisations and foundations." [1]

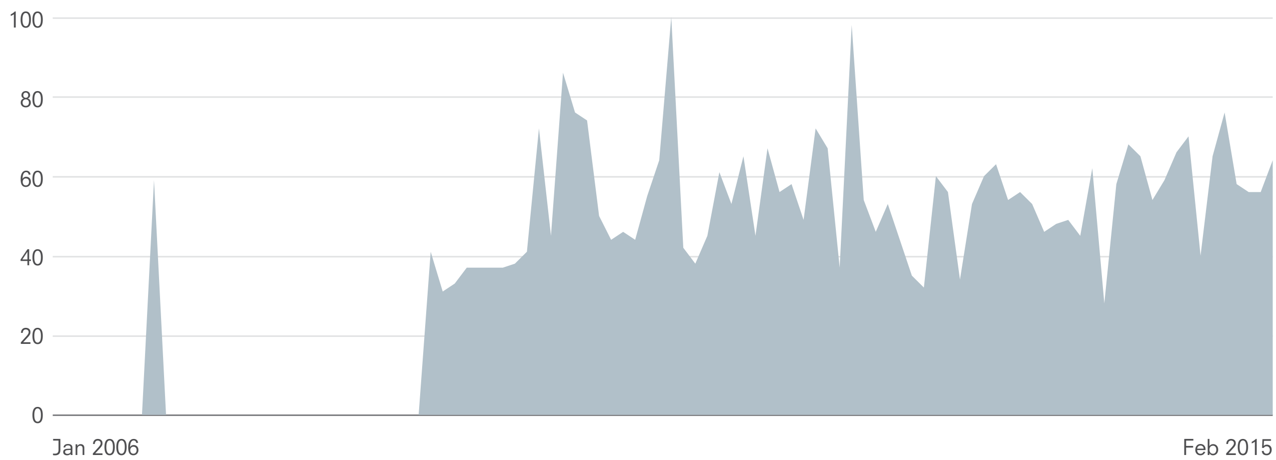
Here, immediately, are two very different conceptions of social investment and ones that bear little relation to its most common use in the UK today. While contexts differ, it is still clear that this is a contested term. It could even be seen as one that has been appropriated by successive UK governments and a small group of policy-shapers, whose power and influence have, unintentionally or otherwise, taken legitimacy away from alternative conceptions of what social investment might be.

Poor communities and underserved markets?

Yet even the Government and these influential advisers have changed their tune over time. The Social Investment Task Force, established at the request of HM Treasury in April 2000, was the first high profile outing for the term "social investment" in a policy context. Members of the taskforce, including Sir Ronald Cohen and David Carrington, have subsequently helped shape what social investment has come to mean over the past decade in the UK.

The taskforce's remit was, originally, particularly focused on creating wealth, economic growth, employment and an improved social fabric in the UK's poorest communities. In Sir Ronald's foreword to the taskforce's 2003 update Wealth beyond Welfare [2], in the first paragraph alone, there are three references to Community Investment Tax Relief and three more to Community Development Finance Institutions. The focus of social investment at this stage, then, was on under-invested communities and economic regeneration, rather than, say, the social sector. Hence those with an attachment to this definition are among the parties expressing frustration when it becomes clear that Big Society Capital has offered little support to CDFIs to date; when a "social investment fund" proudly announces its support for a tech company; or when Big Society Capital invests in a hedge fund-backed model which makes its money out of renting buildings to charities.

Figure 1 – UK Google searches for "social investment" [3]



[1] http://www.uni-heidelberg.de/excellenceinitiative/institutionalstrategy/csi.html

[2] http://www.socialinvestmenttaskforce.org/downloads/SITF_July_2005.pdf

[3] http://www.google.com/trends/explore#q=%22social+investment%22&geo=GB

Investment in the social sector?

For around a decade, responsibility for policy around social investment has sat within the Office for Civil Society (previously Office for the Third Sector). Announcements and speeches tend to emerge from the Minister for Civil Society. Even when the Prime Minister or Minister for Cabinet Office (under successive governments) talk about social investment or Big Society Capital, the rhetoric and case for investment is built on its relevance to the social sector. So, over time, social investment has come to be seen by many as something to do with finance for the social sector.

Yet the social sector already attracts billions of pounds of finance (most of which is not socially motivated). NCVO estimate debt finance for civil society to sit at £3.9 billion.[4] In addition, Alex Nicholls points out[5] that the assets of co-operatives may represent a further kind of multi-billion pound investment in social enterprises.[6]

[4] http://data.ncvo.org.uk/a/almanac14/how-much-is-the-voluntary-sector-borrowing-2/

[5] http://www.birmingham.ac.uk/generic/tsrc/documents/tsrc/reports/SEIF/SEIFPhaseOneThelandscapeofsocialinvestmentintheUK.pdf

[6] …depending on both your definition of social enterprise and your views on Principle 7 of the International co-operative principles).

Figure 2 – The Five Types of Finance

Investment type	Organisation type: Socially motivated	Organisation type: Commercially motivated
Commercially motivated	4	5
Socially motivated	2	3
Philanthropy	1	

CAF point out that "social investors are not the only providers of affordable finance – high street banks, charitable trusts and high net worth individuals can also, in principle at least, lend funds at rates of return that a charity can pay."

So billions of pounds of commercially motivated capital are already being applied to make a difference in the social sector, yet this remains largely unreported relative to the 'noise' around social investment. Other sources of finance and activity have been largely ignored by advocates of social investment – NCVO points out that 'informal loans', often "from trustees or supporters of the organisation" tend to be a key source of loan finance for civil society organisations. These loans "often come with favourable terms, such as very low (or zero) interest rates, and with long periods before repayment or no set repayment date." So clearly, social investment as currently conceived today means something more specific than *access to finance for the social sector.*

Impact investment
In recent years, a new term – "impact investment" - has come more to the fore. The preceding diagram from Adrian Brown of Boston Consulting helps us understand where this may fit in a wider investment landscape.

See Figure 2, p. 22.

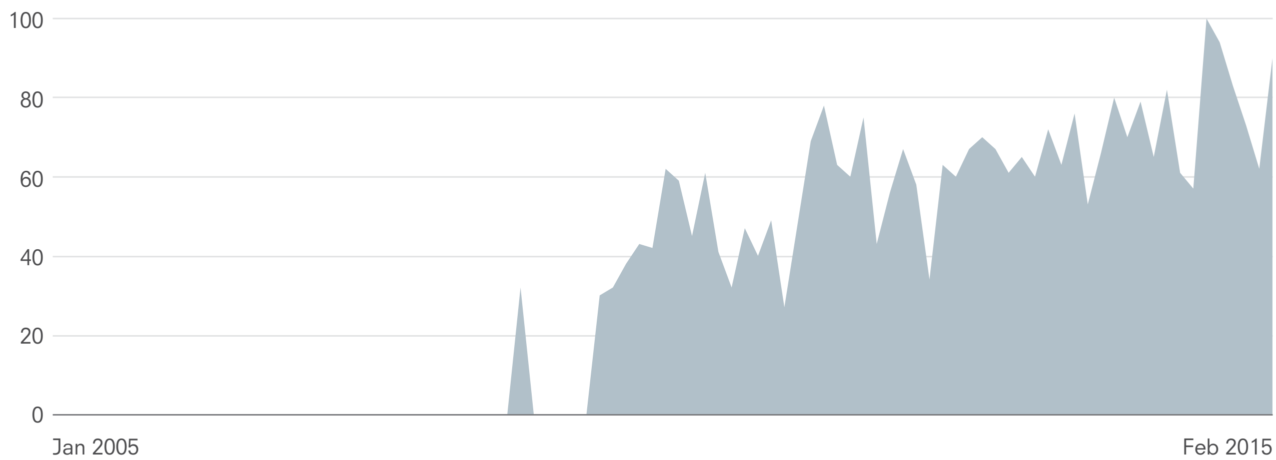
Brown describes the motivation for investment on one hand and the nature of the investee on the other. Brown's report, which was supported by the Government and Big Society Capital is focused "only on socially-motivated investment in socially-motivated organisations (i.e., Type 2 finance)." This also coincides with Big Society Capital's scope of activity in the market to date.

But socially motivated investment, or 'impact investment' as it is perhaps becoming known, could go beyond the social sector. Brown suggests that socially motivated investment in the social sector "is not the only way of defining social investment. Another approach would be to abandon the emphasis on the organisation type of the recipient and replace it with a focus on the amount of social impact created. This could open up new opportunities for delivering social benefit, for example by using commercial enterprises as a vehicle for achieving social good."

See Figure 3, below.

So this distinct interpretation of social investment – or "impact investment" – is about the motivation of the investor and the expected impact of the investee, not the structure, ownership model, governance arrangements or approach to profit distribution of the investee. While barely anyone noticed, the last Government had already made this distinction in its consultation on what has since become Big Society Capital, proposing a "Bank being defined by social and environmental outcomes and not by eligibility on the basis of form. It would be a Social Investment Wholesale Bank and not a Third Sector Investment Bank."

Figure 3 – "Impact Investment" Google searches, worldwide [7]



[7] http://www.google.com/trends/explore#q=%22impact%20investment%22

UK participants in the recent G8 social impact investment programme of events and publications remain interested in this approach, exploring the idea of "profit with purpose" businesses which fall outside most definitions of principally-not-for-profit social enterprise or the VCSE sector but which could be promising candidates for impact investment. For a long time, UnLtd have focused on who they see as social entrepreneurs regardless of whether they are working within a recognised social enterprise structure.[8] Big Society Capital is also interested in whether widening the scope of their potential investee pool, as originally proposed by the previous government.

8 Reference CAN / Senscot story here

But – as above with finance for the social sector – socially motivated investment stretches unnoticed way beyond the impact investment market as currently conceived by its key advocates. Billions of pounds of investment in the arts, films and cultural industries are ignored here. Crowdfunding investors invest almost £2 billion per year, also for mixed motives, such as the desire to support a friend or family member or to support the local area.[9] Angel investors, investing an estimated £850 million per year, also invest for a complex range of reasons (indeed the poor financial returns in the angel and VC markets over the last decade are evidence enough that investors need other reasons to invest beyond purely financial). "Friends, family and fools" commonly invest in the start-up ideas of those they want to support for personal reasons, often social. Investors in publicly listed stocks and shares can bring personal motivations to their investment approach – the FCA describe how consumers of financial services may be influenced by emotions and psychological experiences, by preferences, beliefs, social influence and other factors.[10]

9 http://www.thecrowdcafe.com/crowdfunding-motivations/

10 https://www.fca.org.uk/static/documents/occasional-papers/occasional-paper-1.pdf

So it seems that social investment as currently conceived is also something more specific than the broader "investment which is made for a social purpose".

Social *and* financial return?

Adrian Brown's helpful table draws a distinction between three types of motivations for investors – purely financial; purely philanthropic; and socially motivated but seeking financial return. This third category of social investment comes with mixed motives or seeks blended value – as Boston Consulting Group report "there must be some expectation on the part of the social investor that they will be able to get their money back with a return."[11]

11 BCG

Yet this is another element to social investment which has changed over time. Investment in the economics profession or in the context of public accounting does not by definition require a return. "Social investment" has been - and sometimes still is - used by some to include grants and donations (albeit perhaps just capital grants or development grants rather than revenue grants). In economics, investment is the acquisition of goods which are used in the future to create other goods and services. In government accounting terms, investment is any expenditure which buys something which lasts longer than a year. Social investment could, like public or private investment, be defined in the same way. In fact, Trident Housing[12] – by itself with assets around three quarters of the value of the entire "social investment market" – appears to use the term social investment in this sense.

12 http://www.trident-ha.org.uk

There is also little clarity of what is meant by return in this context. Working upwards from a minimum of zero return, does this mean:

a) return of some of the initial capital outlay;
b) return of all of the initial capital outlay;
c) return of the initial capital plus interest; or
d) return of the initial capital plus interest above inflation / cost of capital / discount rate?

Finally, working downwards from maximum financial return, should social investors be seeking less - or more modest - return than commercially motivated investors? Otherwise, social or impact investment could logically also include trillions of pounds of 'conventional' investment, which, alongside financial return, also creates jobs, goods and services which people want, food, warmth, shelter and other types of positive impact.

So for some, social investment refers to activity where a lower degree of financial return becomes acceptable for the same level of risk, or greater risks are taken for the same return. But there is little consensus here. Some believe social investments can even outperform conventional investments in the long run. Others think they can stack up but on a more modest basis than other asset classes. Some see social investments as a response to market failure that are unlikely to be able to sustain themselves in financial terms.

While there is little consensus here, the current coalition Government and Big Society Capital have shaped conceptions of what returns are to be expected in a social investment context. Big Society Capital defines social investment as "the provision and use of capital to generate social as well as financial returns." This is generally understood to mean at least the return of the initial capital outlay.

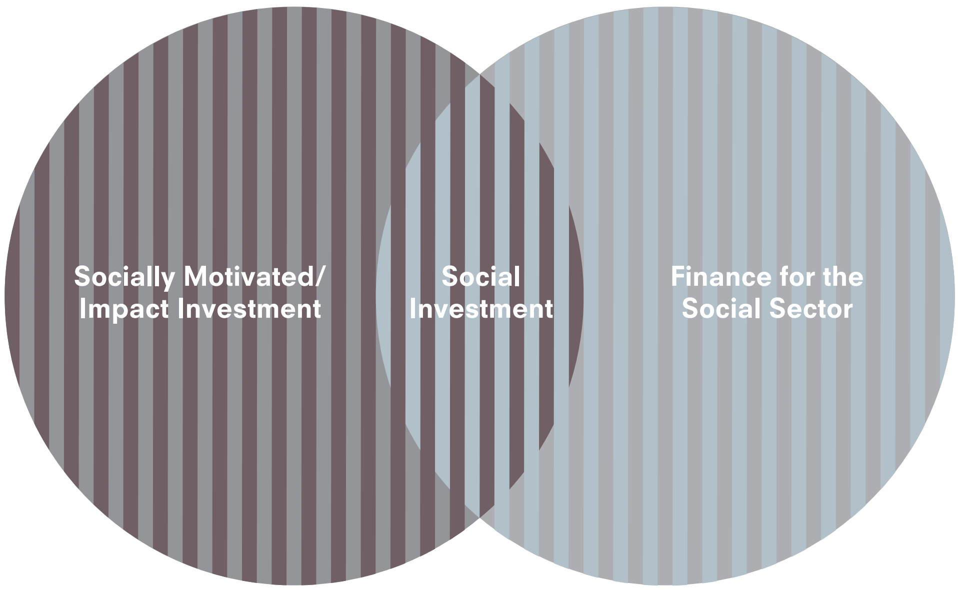
Social investment defined

So social investment has come to mean: something to do with access to finance for the social sector; something to do with socially motivated investment; and also an activity which returns capital to the investors.

It has also been increasingly described as a market, an idea crystallised around the middle of the last decade. In 2007, the Treasury and the Cabinet Office for the first time talked about – and helpfully defined – the social investment market "that is, investment made for a social purpose in organisations that are committed to delivering benefits for society and the environment." [13]

[13] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/228900/7189.pdf

So in this way, the social investment market has come to refer to investment activity where a) demand for finance for social sector organisations is met by b) socially motivated or impact investment (never mind that these two worlds independently reach way beyond the territory upon which they overlap).



Government and the Cabinet Office's policy focus is centred on this overlapping area of activity. This may help explain various frustrations in some quarters with the role of the "social investment market". On one hand, for the social sector, sources of potential finance are far wider than those emphasised and trumpeted by policymakers, which then consequently seem rather irrelevant and unimportant. The University of Manchester (a charity), for example recently issued a £300 million pound bond which alone puts the so-called social investment market of around £200 million pounds a year rather in context. Equally, Big Society Capital manages hundreds of millions of pounds while the British Business Bank manages billions and the Bank of England prints hundreds of billions through its programme of Quantitative Easing, both of which have a greater impact on the availability of finance to SMEs.

On the other hand, for investors, the market is perhaps too narrowly focused on a certain set of tightly defined organisations - the number of people who want to use their investments to change the world is certainly larger than those who are happy to be told by the government how to do so "and to have the target of their investments so narrowly defined."

'Social investment' as currently defined

The following are ten definitions of 'social investment', 'impact investment' or 'social impact investment'. Eight of them are either from the websites of, or reports commissioned by, leading stakeholders in the UK social investment market. Two of them are from prominent international reports. "For the purposes of this report we use the term 'social investment' to refer to any form of finance offered to social organisations with the expectation that there will be a financial repayment. It does therefore include partial and full loans and equity structures but it excludes grants, where there is no expectation of repayment." – Investment Readiness In the UK (Commissioned by Big Lottery Fund)

(1) "the key criteria that define social investment are: that the social returns, such as finding work for the long-term unemployed or providing care to the over 65s, are clearly defined a priori and are not an incidental side effect of a commercial deal;

(2) that the investor expects a financial return. To draw a bright red line between social investment and variants of philanthropy, we advocate for social investment to include only finance that is anticipated to deliver at least a 0% return (i.e., repayment of capital)" – *Lighting The Touchpaper / The First Billion (Commissioned by Big Society Capital)*

"Social investment provides capital that enables social organisations to deliver both social and financial returns. The investment is repayable, often with interest, and is typically used to develop new or existing activities that generate income – such as trading activities or contracts for delivering public services." – Cabinet Office[14]

"Social impact investment is the provision of finance to organisations addressing social needs with the explicit expectation of a measurable social, as well as financial, return." – *OECD, Social Impact Investment, Building the Evidence Base*

"Social Impact Investments are those that intentionally target specific social objectives along with a financial return and measure the achievement of both." – *G8, The Invisible Heart of Markets*

"In this study, 'social investment' is understood as investment that provides a social as well as a financial return. The Charity Commission differentiates between two types of social investment in its investment guidance:

i. Programme related investment: investing to directly further the charity's aims whilst potentially also generating a financial return.
ii. Mixed motive investment: investing both to further a charity's aims and to generate a financial return.

[14] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/353044/CO_Social_investment_background_one-pager_July_2014.pdf

This study does not cover other types of financial investment that charities can be involved in, including ethical investment. – *IVAR*. Impact investment aims to bring about positive outcomes for people, communities and society as a whole, as well as providing financial returns for investors. Impact investment is needed to fund the creation of new innovations and to support their testing and development. It also allows the best ones to scale up and change the world. This is as true of innovation that seek to achieve social impact as it is of those motivated by creating financial value." – *Nesta*[15]

[15] http://www.nesta.org.uk/get-funding/impact-investments

"Social investment is the provision of finance to organisations with a clear charitable or social agenda, to generate both social and financial return." – *CAF Venturesome*

"Social investment means the provision of finance to achieve a combination of economic and social goals. Economic objectives are straightforward, but social goals represent a new frontier in investment." – *Clearly So*

"Impact investment looks for social impact alongside financial returns." – *Social Finance*

Definitively maybe

The first definition, from the 2012 Big Lottery-commissioned report, Investment Readiness in the UK, is an anomaly. It is the only one to include all repayable investment in social organisations – as opposed to investment where the investor has some kind of social motivation for their investment. That distinction is the difference between a market for repayable finance for the social sector, estimated to be worth over £4 billion and 'the social investment market' that, at last estimate, was worth around £200 million. The other definitions differ in emphasis but all describe an approach defined primarily by the intentions of the investor, while two or three of them also highlight the nature of the investee as having a social purpose.

What none of these definitions do is to make any reference to how the 'social' nature of the investment makes it different in a practical sense to conventional investment. The defining characteristic of social investment as currently conceived appears simply to be social *motivation* – often of the investor and sometimes of the investee.

The Social Investment Market

The common conception of this "social investment market" among policymakers and supporters has arguably been rather narrow and blinkered. The City of London's Growing the Social Investment Market[16] was the latest attempt to establish the scale of the market, putting it at around £200 million per year, a figure than subsequently adopted and trumpeted by the UK Government. Yet this research looked mainly at fund models and was "focused on the investment activities of UK SIFIs and the broader social venture lending of Community Development Finance Institutions (CDFIs)" It therefore did not appear to consider:

> community shares activity;
> charitable bonds
> crowdfunding investments in social enterprises;
> lending and investing by trustees, friends and family;
> investments by social enterprises in other social enterprises e.g. the Phone Co-ops's investment in HCT Group or Albion Health investing in Active Minds
> other under-the-radar activity, such as the RFU's investment in rugby club community benefit societies or councils such as Somerset or Lancashire investing directly in social enterprises;

[16] https://www.cityoflondon.gov.uk/business/economic-research-and-information/research-publications/Documents/research-2013/Growing-social-investment-market.pdf

All of these meet the narrowest definition of social investment as socially motivated investment in social sector organisations. But they remain too often ignored. As Danyal Sattar of BSC says "There is a pool of people out there who have always done social investment, but don't pop up anywhere, because they are not institutional, social enterprise, or connected to government, whose social investment interests do not get represented."

Section What's Social About Social Investment?

2B 'Social Investment' as experienced by social sector organisations

28 Our roundtable discussions produced a wide range of views on the meaning of 'Social' in social investment – based both on current experience and perceptions about what it does mean, and ideas and aspirations for what it could and should mean.

It many cases the practical expectation of social sector organisations and support organisations was that social investors would be able to offer more generous terms that mainstream finance or would invest in organisations that the mainstream wouldn't. Some of the points made included:

- > You should only go to a social investor if you are unbankable
- > Social investment should be patient
- > Social investment either would not or should not deliver a high return
- > In terms of 'what happens when it goes wrong?' – trustees assume that banks want their pound of flesh but the hope/assumption is that social investors and/or an expectation of a soft landing

Some attendees saw potential benefits from social investment in terms of changing the way the charity and social enterprise sectors do business, they suggested that:

- > The important thing is not the sum of money invested but inculcating a culture, building organisations' confidence to take on finance and operate in a business like way
- > It is about creating long-term sustainability, decreasing grant dependency, going over to long term trading activities
- > Profit making in the social sectors has (in the past) had a punitive effect because funders have cited reserves as reason for refusing funding

Many attendees felt that SIFIs and others involved in the development of the market needed to do more to understand and offer something distinctively useful to the market they are operating in. Points included:

- > Social investors need to understand that in private business risk is mitigated by personal guarantees from directors because they will profit if things go well – in a social sector organisation the profit side is not there
- > Social lenders need to understand the complicated public sector markets that many social enterprises operate in
- > SIFIs need to market themselves better – reach out and engage more, talk to social sector organisations about what they want
- > Organisations want to know what, if bank and social investors could offer the same financial terms, what would make a social investor more attractive – it could be understanding, interest in the journey and buy in to impact

There was also some wider concern about the way the term 'social investment' was being used, and some of the activities included under the umbrella. Points include:

- > Twenty years ago, social investment was public works funded by the World Bank. Then these finance people put 'social' on all sorts of things
- > The term 'Social Sector Organisations' is a slippery slope. We should stick to a clearer and more pure something?
- > Some CICs are set up to benefit people running them
- > More thought and communication is needed to demonstrate what's different about social investment
- > You can draw a clear line from Futurebuilders to where we are now: scaling up, PbR, agenda around public services, creating a sector where there hasn't been one

Two of our roundtables in particular – in Scotland and with London Funders – featured prominent contributions from funders and intermediaries on the question of 'What's social about social investment?' The points they made included:

- > It's about engagement. Part of the lending process is to measure the social impact. There's a scorecard. We agree on outcomes together
- > The impact grid is filled in with the customer. We may allocate funds based on higher impact
- > There's a limited pot of money. We've turned down organisations who just wanted to buy a building to sustain existing levels of activity.
- > A lot of it is about how much you value social outcomes. There's no reliable way of measuring that risk and return trade off. We need to start valuing social returns properly so we can price loans more accurately for social enterprises
- > We are subsidised but there's a lot of philanthropic capital out there. We are the only philanthropic social fund out there. It's about finding ways to unlock that efficiently
- > We originally focused on getting money to social organisations, now we've moved towards systems change
- > What's social is a meeting of minds between organisations and the people who want to put the money in

Respondents to our online survey, address the survey question 'What do you consider social about social investment?' from a range of different angles.[17] These included

[17] Respondents had the option of whether or not to include their name and organisa tion details and, where no details are shown, the respon dent has chosen to remain anonymous

1. **The intention behind the investment and the motivations of investors:**

"The expectation that as well as being repaid, the funds will be used to contribute to the creation/extension of a socially 'good' thing" – *Adrian Ashton*

"The purpose of the investment" – *B Tarring*

"It is where the investor is motivated to seek both social impact and a financial return. The quality & certainty of the promised social impact influences investor attitude to risk" – *Robert Ashton, Swarm Apprenticeships*

"Investors who understand that achieving social impact sometimes impacts on financial return" – *Kate Welch, Social Enterprise Acumen*

2. **The type of organisation being invested in:**

"Investing in a business that wants to solve a social problem in a way where profit and massive scale is not the prime objective where the business model is good." – *Laura Willoughby, Club Soda*

"That it is supposed to invest in social enterprises that bring about social change."

"Normally organisations provide a social good (e.g. health care, environmental work and housing maintenance) and most of the profits (51% or more) are re-invested in the business or other social activity and not taken as profit. I personally think 51% is too low, particularly as some social enterprises have turnovers of millions and very high profits. I would prefer to see a figure of 80%+." – *Tony Jones, Landlife National Wildflower Centre*

"Due diligence & return incorporates social impact. It is for charities & social enterprises."

"The investment is in enterprises/organisations/groups that are no- profit, outcome based on public benefit, common good and tackling disadvantage." – *Bill Osborne, VSB*

3. **The beneficiaries of the investment:**

"Community managed assets. Community managed organisation, community owned. The social refers to who owns, manages or supports these types of projects." – *Heidi Seary, Federation of City Farms and Community Gardens*

"Something that benefits a community of interest and helps that community be on a 'level playing field' with other communities" – *Mark Ellerby, Cloudberry*

"It benefits the community"

"That it delivers social change, addresses causes of injustice, lack of dignity or safety. It needs to be linked to the outcomes valued by beneficiaries. The investment ought to be driven by the achievement of this change not profit." – *Renae Mann, Inclusive Change Consultancy*

4. In some cases, they looked at what it meant for their own organisation:

"I'm not sure, other than we could access it" – *Charles Rapson, Colebridge Enterprises*

"Understanding that I'm running a business that is doing social good so where as I would expect a bank to be confused by the dual missions, I won't expect social financiers to be. A loan is a loan. It doesn't matter if it's for a social business or a business. An investment has to be for expenditure that with result in profitable (surplus generating) business carried out. It can't be a pseudo grant. Many charities haven't got business models that are capable or ready to take business funding." – *Colin Vint, Boxford Build CIC*

"Very good question: perception by my Trustees that investors were carrying more risk than conventional lenders would. The real measure will be if investments don't go as planned how 'social' will investors be at that stage?" – *Ashley Horsey, Commonweal Housing*

What's impactful about 'social impact investment'?
As is evident from the '10 definitions of social investment' quoted earlier in this chapter, the idea of 'Impact investment' or 'Social Impact Investment' is increasingly popular as an alternative to, or elaboration, on "social investment'.

The two definitions that used the term 'Social Impact Investment' were from international reports, the 2014 G8 Taskforce report, The Invisible Heart of Markets, and the 2015 follow-up report from the OECD, Social Impact Investment, Building the Evidence Base.

The definitions are quite explicit in stating that for an investment to be a 'social impact investment', the social impact does not just have to exist, it has to be measured:

"Social impact investment is the provision of finance to organisations addressing social needs with the explicit expectation of a measurable social, as well as financial, return." – OECD, Social Impact Investment, Building the Evidence Base

"Social Impact Investments are those that intentionally target specific social objectives along with a financial return and measure the achievement of both." – G8, The Invisible Heart of Markets

Currently, there seems to be significant gap between rhetoric and reality. There was very little discussion in our roundtables about impact measurement – aside from one instance where a government funded SIFI talked about some SROI reports they had been forced to request but which had since lain unread in a filing cabinet for years.

This is not to say that organisations believed that SIFIs and other social investors were uninterested in social impact. Rather that social investors expectations of social impact was primarily regarded as being important in determining whether they chose to invest or not.

The same was true of SIFIs themselves. Some were clear about the scoring processes they used to decide whether an investment was 'impact' enough to consider but, once that decision had made, there was no expectation of detailed social reporting.

There is a significant exception to this situation within the UK social investment market. The UK is a pioneer in supporting one particular model of social investment, the 'Social Impact Bond' (SIB)[18], in which measurable social impact/outcomes are fundamental to the business model.

[18] https://www.gov.uk/social-impact-bonds

One participant in our roundtables was from an organisation delivering services as part of a SIB and discussed the pros and cons of the model: the advantage of (hopefully) being able to prove the effectiveness of the services vs. the increased cost of delivering the service while managing and measuring it via a special purpose vehicle.

Nesta Impact Investment are one of the SIFIs based know for their active interest in measurable impact. In a recent blog post[19] Nesta's, Eibhlin Ni Ogain, explained that: "Nesta Impact Investing's approach to impact measurement promotes the use of rigorous methods, control groups, randomisation and replication."

[19] https://nestainvestments.org.uk/in-defence-of-empiricism/

However, she observed that the rest of the sector had 'a long way to go', referring to a June 2014 survey by GIIN and JP Morgan[20] which found that while 95% of impact investors use 'standard impact metrics', only 8% consider it important to gather data on the efficacy of investments.

[20] www.thegiin.org/binary-data/2014MarketSpotlight.PDF

Roundtable on Impact Measurement
The one of our roundtables where impact measurement was firmly on the agenda was the roundtable organised by Professor Alex Nicholls specifically to look at the role impact measurement in the UK social investment.

The roundtable included impact specialists from a range of SIFIs and support organisations. Key questions and discussion points emerging from the roundtable included:

> The need to distinguish between performance management (for a an internal audience) and performance measurement (for an external audience)

> The need to distinguish between the impact or outcome of revenue funding, which is of a transactional nature as opposed to capital or investment. The latter is not necessarily predicated on buying outcomes and is more likely to be about supporting capacity building or development. So the task of measurement in an investment context is complex and may even be unnecessary or inappropriate. Additionality and attribution are key analytic issues here. For example, an investor may help a charity to grow as it is able to encourage more public bodies to buy its services as a result of the investment. But how are the additional impacts attributed between the public bodies (who after all are paying for the outcomes) or the investor (who made it possible)?

> Is there a role for external advisory groups to help standardize metrics/units of impact? SIBs?

> *Need to create a social impact data commons - how can organisations that measure impacts, included SIFIs, share that information with each other and more widely?*

> *Different players in the social investment ecosystem could collaborate better on sharing measurement methods, standards, best practice and data to help build skills*

> There is value in testing the relationship between social risk and return more fully with relevant data – Are investments which carry a bigger financial risk more likely to deliver a bigger social return? Are activities which carry a bigger risk of not working, in a social sense, more likely to deliver greater social impact if they do work?

> How can impact measurement enhance contracting under the SV Act?

> There is a need to understand why some organizations/projects do not engage in impact measurement: what is the moral basis of insisting there should be impact measurement? What is the regulatory justification? To protect investors? Currently impact measurement happens primarily because funders request it. If organisations are going to actively choose to do it they need to understand why they should – how it will enable them to do what they do significantly better. The challenge for those who support increased impact measurement is to have an explanation as to why measurement is useful to organisations and the people they work with and communicate it effectively.

The balance of social and financial return

One set of questions which remains after our roundtables was whether any SIFIs or other social investors (in the UK or elsewhere) have a clear understanding of the relationship between social and financial returns generated by their investment:

> Do any social investors offer investees better deals – lower interest rates or fees or more patient terms or take more risk - based on the social impact an investment is predicted to generate?

> Do any social investors offer investees better deals based on measurable social impact achieved? For example, an investor might agree to write off a proportion of interest due based on a set of social outcomes being delivered.

Conclusions

When it comes to the current conception of the social investment market, it is possible to draw the following conclusions:

1. Understanding of what the market is has been contested, has changed over time and is far from robust.[21]

2. Impact investment is widely understood to refer to the motivation of investors and the impact they seek, regardless of the type of investee.

3. While there is some overlap, this is not the same as access to finance for the social sector (or civil society, VCSE sector, etc.).

4. Social investment as defined by the UK government and Big Society Capital tends to refer to socially motivated investment in the social sector, which returns at least the money invested. While activity in this space is probably far bigger than recent estimates - which have focused too narrowly on fund models – it is much less important and interesting to both social sector organisations and socially motivated investors than the rhetoric over the last few years would suggest.

5. There appear to some expectations in the market that, in practice, social investment should be somewhat different to conventional investment in practice. For example, by meeting gaps in the market, or it may be more patient, less risk averse and more knowledgeable about the needs of social sector organisations than mainstream investors.

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[21] See EVPA for one particularly confusing definition of social investment "defined as being the supply of finance and non-financial support with the objective of strengthening an organisation's social, economic, environmental or cultural impact whilst potentially seeking a financial return on capital and/or community or organisational financial sustainability and viability."


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Section

3 Who Are Social Investors And What Do They Want?

36 As explored above, 'Social Investment' as currently conceived appears to be different to 'conventional' investment only in terms of the motivation of the investor.

This section looks at some of the different groups of 'social investors' currently operating in the UK and their functions and motivations. It also outlines how the role of 'social investors' is understood by attendees at our roundtable events and respondents to our online survey. We then look at the role of these investors in meeting demand from social sector organisations, in particular focusing on the unmet demand for 'cheap, risky, long term growth finance in the tens – but not hundreds – of thousands', in line with what the evidence suggests.

We explore the following groups of investors:

(i) Government
(ii) Big Society Capital
(iii) Social Banks
(iv) Other SIFIs
(v) Individuals
(vi) Social Sector Organisations
(vii) Charitable Foundations

(i) Government:

The UK government has been the single biggest social investor in the UK, albeit with programmes often focused on England only or England and Wales, rather than across the whole of the UK. Central government departments provided over £300 million of capital for social investment programmes between 2004 and 2013. While some may see this as public, rather than social investment, we still explore it here, not least as the Government itself has commonly described these programmes as 'social investment'.

Funds initiated directly by UK central government departments, directly badged as, or associated with 'social investment' under the previous Labour administration have included:

> Adventure Capital Fund – Home Office – around £25 million – 2002
> Futurebuilders – Cabinet Office – seemingly around £150 million from total commitments of £215 million (which may include unspent funds and management fees – 2004-2010)
> Risk capital fund for social enterprise – Cabinet Office – around £6 million - 2007 onwards
> Social Enterprise Investment Fund – Dept. of Health – around £110 milllion – 2007-2013
> Community Builders – DCLG – around £70 million – 2009 – 2012

These funds provided a mixture of grants, loans and business support.[1]

Funding to subsidise investment activity:
The more recent UK coalition government has sought to reduce its role as a direct provider of funds for social investment and has sought to support the market in other ways, alongside the creation of Big Society Capital (see below) including:

> Social Incubator Fund – around £10 million – Cabinet Office – funding for social incubators to provide 'investment and support to early stage social ventures'
> Investment and Contract Readiness Fund – around £10 million – Cabinet Office – grants to enable social sector organisations to buy consultancy to help them become 'investment ready'
> Commissioning Better Outcomes fund – £60 million – Cabinet Office – (in partnership with Big Lottery Fund) – Subsidies to reward outcomes generated through Social Impact Bonds through programmes such as the Fair Chance Fund[2]
> Access – a new programme launched in spring 2015 in partnership with BSC and the Big Lottery

What they want:
For successive UK governments, social investment has been seen, at least in part, as a tool designed to enable more social sector organisations to take on contracts to deliver public services. Futurebuilders was explicitly about this and in their 2011 social investment strategy,[3] Cabinet Office Minister, Francis Maude and Minister for Civil Society, Nick Hurd, linked their support for social investment explicitly to 'public service reform'. They explain that: "we will break up public sector monopoly suppliers, encourage a wider diversity of providers, and give more choice and control to service users."

The key policy change since 2011 is that, following the decision to create BSC, central government is less directly involved in the supply of capital for social investment: the investment of 'unclaimed assets' into BSC was made with intention of creating a sustainable 'social investment market'.

[1] The amount of repayable social investment made by each fund was significantly less than the total value of the fund

[2] https://www.gov.uk/government/news/23-million-to-help-homeless-turn-around-their-lives

[3] https://www.gov.uk/government/publications/growing-the-social-investment-market-a-vision-and-strategy

The ministers explain: "This is not about handouts – it is about encouraging a new, self-sustaining market to grow, free of state interference."

Attitude to risk and return:
Although UK government-backed social investment is (at least partially) repayable finance, the government has not been driven by seeking a financial return for itself from investments. Any repayments received from social investment funds have generally been channelled back into further support for the 'social investment market'.[4]

Role in meeting unmet demand from social sector organisations:
Often, programmes have been predicated on an assessment of market failure but also with regard to wide policy objectives. The social investment programmes funded by UK governments between 2004 and 2013 were, in most cases, part of a broader policy framework aimed at supporting social sector organisations to enter or compete more effectively in public service markets. They often did not aim to meet demand from social sector organisations who were not attempting to enter public service markets.

The mix of grant and loan finance provided by a number of these programmes was not available from mainstream banks. However it is hard to assess the degree to which these programmes were successful in meeting unmet demand as, on several occasions, the aims of the funds evolved in response to slower than expected uptake. For example, some of the Futurebuilders money was redirected towards grant programmes and, according to one evaluation, 86% of funding distributed by the DH-backed Social Enterprise Investment Fund was in the form of grants,[5] while the original intention of the fund were for it to be self-sustaining

Conclusion:
It seems that a range of government funds under the Labour governments sought to meet some unmet demand for finance and, under the Coalition Government, to help social sector organisations access other sources of available capital. But the sheer range of funds, the way in which they have changed direction over time, and a lack of clarity over how the money has been invested makes it hard to assess their effectiveness in meeting perceived demand.

(ii) Big Society Capital:

The Dormant Bank and Building Society Accounts Act, passed under the previous Labour government in 2008, enabled the use of 'unclaimed assets' from dormant bank accounts to capitalise a 'social investment wholesaler'. In May 2011, the Coalition government endorsed the creation of a 'Big Society Bank' to perform that function.

Big Society Capital (BSC) was set up in 2012 by the UK government to act as a social investment wholesaler with more than £600 million to invest:

> £400 million (at least) of quasi-public money from unclaimed assets; together with
> £200 million from 'the Merlin banks' – the UK's four largest high street banks

The 2008 Dormant Bank and Building Society Accounts Act defines a 'social investment wholesaler' as a body that "exists to assist or enable other bodies to give financial or other support to third sector organisations", and that a third sector organisation is one that "exists wholly or mainly to provide benefits to society or the environment".[6]

[4] https://www.gov.uk/government/news/government-unveils-major-boost-to-social-investment-sector

[5] http://beanbagsandbullsh1t.com/2012/12/17/youll-never-take-a-loan/

[6] http://www.bigsocietycapital.com/sites/default/files/pdf/BSC%20investment%20policy.pdf

BSC's primary function then, is to invest its money into Social Investment Finance Intermediaries (SIFIs) who then invest in social sector organisations.[7] It has also made investments into organisations aiming to develop the infrastructure for 'the social investment market'. These investments include: Social Stock Exchange,[8] a website promoting social impact measurement by listed companies[9] and Clearly So,[10] an organisation that supports social enterprises to raise money.

What they want:
BSC's investment policy states that: "Every investment Big Society Capital (BSC) makes should contribute to our mission: to shape and grow a sustainable social investment market in the UK.

For this to happen, we seek to combine three objectives in every investment: maximum social impact, a contribution to developing the social investment market, and a financial return."

Attitude to risk and return:
BSC's overall position on financial return is: "We aim to balance our mandate to develop the social investment market and create positive social outcomes with the need to generate long-term financial returns. We ourselves need to ensure that we are sustainable as an organisation and that our capital is preserved." As well as wanting to keep going itself, BSC also seek a return in order to prove that social investment works: "If BSC achieves a long-term financial return, it will help to prove the financial case for social investment and help to attract mainstream capital into the market."

Yet BSC also perceive their own investments to be 'high risk: "The nature of BSC's proposed investment activity is high risk and not currently undertaken by mainstream financial services. Some of the target organisations will have no operating track record. Furthermore, under its 2012 State Aid exemption[11] application, BSC can only operate in areas where market failure has been identified."

BSC's investment policy of seeking to generate financial return and maintain its own viability flows from some combination of one or more of the following factors:

> the need to repay investment from their co-owners, the Merlin banks, under an agreement struck between the banks and the Coalition Government
> the policy directions issued by Francis Maude around the time of BSC's creation and subsequent ongoing political influence[12]
> what is allowed under the European Commission's approval of State Aid clearance for Big Society Capital[13]
> the ongoing direction of Big Society Trust Board and the Big Society Capital Board

Role in meeting demand from social sector organisations:
As a wholesaler, BSC do not play a direct role in meeting demand from social sector organisations. BSC's role, both as a wholesaler and as the organisation primarily responsible for the development of a 'social investment market' is explored in detail in Section 4.

Conclusion:
BSC appears to have a mandate to address unmet demand but subject to a number of quite significant constraining conditions, such as the need to work through intermediaries, to finance its own continued existence from returns and to co-invest alongside others. It would be helpful to observers of the social investment market and government policy to have a clearer picture of what continues to drive BSC's investment approach.

[7] http://www.bigsocietycapital.com/who-we-fund

[8] http://www.bigsocietycapital.com/how-we-invest/social-stock-exchange

[9] The organisation has plans to develop a secondary market for social investments

[10] http://www.bigsocietycapital.com/how-we-invest/clearlyso

[11] http://www.bigsocietycapital.com/sites/default/files/EU%20State%20Aid%20Decision_BSC_website.pdf

[12] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/60547/big-society-bank-francis-maude-letter.pdf

[13] http://www.bigsocietycapital.com/sites/default/files/EU%20State%20Aid%20Decision_BSC_website.pdf

(iii) Social banks:

Social banks are commercial banks with a social and/or environmental purpose. They offer a range of products to both social and mainstream businesses – and, in some cases, individuals – however they specialise in making investments into organisations with social aims.

The CDFA reports[14] that in 2014, the four major social banks – Triodos, Unity Trust, Charity Bank and Ecology Building Society – lent a total of £66.4 million to 109 social enterprises with an average loan size of £609,000 (102 / £35 million – 2013, 170 / £135 million – 2012, 269 / £140 million – 2011, 378 / £148 milllion – 2010)

What they want:
Social banks want to invest in what Triodos bank describes[15] as 'companies, institutions and projects that clearly benefit society and the environment'. They finance these investments from deposits and investments made by individuals and institutions. Each of the social banks has a particular focus. Charity Bank, for instance is focused on charities while Ecology and Triodos are less concerned with legal or ownership forms and take a more thematic approach. Unity Trust Bank has a particular history of supporting unions and CDFIs, for instance, as well as others.

Role in meeting demand from social sector organisations:
Social banks often provide social sector organisations that are in a position to take on mainstream finance with a social alternative. Often they provide finance on much the same terms, at the same price or in a similar way to a 'conventional' bank. In doing so, they have consistently been the largest sub-sector of the social investment as currently conceived and reported. However, given that they offer predominantly secured loans of an average size of £609,000, they do not play a major role in meeting unmet demand, as identified above, for 'cheap, risky, long-term growth finance in the tens but not hundreds of thousands'.

Conclusion:
Social banks dominate the social investment market as currently conceived. Indeed their role has perhaps been underappreciated given their dominance of the current market. Triodos, Charity Bank and Unity Trust Bank are likely to continue to play a valuable role in providing relatively safe, asset-backed finance to the social sector as they have done for many years. Yet they play a very limited role in meeting the kind of unmet demand as identified above, and in the policy narrative around social investment.

(iv) Other SIFIs

Social Investment Finance Intermediaries (SIFIs) is a term that has come to be used to distinguish organisations that make investments directly in social sector organisations from those who act as 'wholesalers' or who indeed are the 'ultimate investors'.[16]

BSC is a wholesaler, working through SIFIs to the 'frontlines' of the social sector. Social Banks are SIFIs – an individual who deposits their money with Triodos in an ISA is ultimately financing the investments made by Triodos, which plays the role of intermediary or SIFI – but the term is most commonly used to refer to those SIFIs distributing funds supplied by wholesalers and other large scale social investors.

SIFIs are quite a diverse set of institutions. In terms of size of investment offered, they range from: Key Fund – 2013/14 average loan size: £20,161; Investments agreed: 168; Total invested: £3,272,721; Loans: 65% unsecured / 35% secured[17] – to Bridges Ventures[18] who make an average of just over one investment per year through their 'Social Entrepreneurs Fund'.[19] These are relatively large investments into relatively large

[14] http://www.cdfa.org.uk/wp-content/uploads/2010/02/CDFA-ICF-Report-2014.pdf

[15] https://www.triodos.co.uk/en/business/borrowing/

[16] The term is also used to refer to organisations that carry out related functions including business support, brokerage and, in the case of Social Impact Bonds, contract management

[17] http://thekeyfund.co.uk/wp-content/uploads/2014/10/Social-Impact-Report.pdf

[18] http://www.bridgesventures.com/social-sector-funds/social-entrepreneurs-fund/

[19] Invest in social sector organisations is only part of Bridges' wider programme of investment

social sector organisations. For example, in 2014, Bridges partnered with another SIFI, Big Issue Invest, to make an investment of £1.25 million into social enterprise nursery provider, London Early Years Foundation.[20]

Many SIFIs are also Community Development Finance Institutions (CDFIs): organisations that "provide loans and support to individuals and enterprises unable to access finance from the mainstream financial services sector, enabling them to contribute to their local economy."[21]

According to the CDFA report, Inside Community Finance 2014,[22] CDFIs (excluding Social Banks) lent a total of £12 million to 261 social enterprises in 2014 with an average loan size of £46,000, average term of 5.5 years and an average interest rate 8% APR.

Since 2012, both new and existing SIFIs have created new funds supported by investment from BSC, mostly offering investments of £250,000 or more. So far, these funds have made relatively few investments in social sector organisations (See Section 4).

What they want:
SIFIs aim to make investments that generate both social and financial returns. They need to cover their costs in some way but they do not necessarily aim to do so through income from investments. This means that, in principle, they may be able to take higher levels of risk and / or accept lower returns than other more conventional financial institution if they can find other ways to subsidise their investment activity.

Attitude to risk and return:
SIFIs approaches to risk and return are primarily dictated by the investors whose money they distribute. Many loans made by CDFIs, for example, are subsidised in some way, either by being provided alongside a grant or due to some of the CDFI's management and support costs being funded by a grant or contract from a public sector agency. (See Section 4).

CAF Venturesome,[23] for example, invests funds donated to it primarily by trusts and foundations or High Net Worth Individuals (HNWIs). Venturesome does aim to get its money back and charge enough interest to cover costs but the fact that it does not have to repay money to its investors means it is able to make smaller, riskier investments than would be possible for a more conventional institution with an obligation to return capital to its own investors or depositors.

NB: As the biggest single supplier of investment funds to SIFIs, BSC plays a major role in determining SIFIs attitudes to risk and return.

In practice, as BSC seeks a financial return from SIFIs, this means that SIFIs taking BSC investment have to invest in social sector organisations at a level that enables them to both repay the investment and cover their costs in the process.[24]

Role in meeting demand from social sector organisations:
There is some evidence that smaller SIFIs, particularly those who are also CDFIs, do currently meet demand for 'risky, long-term growth finance in the tens but not hundreds of thousands' though not at a price that social sector necessarily regard as 'cheap' or even sometimes 'affordable'.

Conclusion:
SIFIs are at the heart of the idea of social investment as currently conceived. They are integral to the model of Big Society Capital. Yet it is currently unclear, and there is little evidence to suggest how SIFIs can meet unmet demand while also delivering returns to investors, at least at a scale which lives up to the rhetoric of social investment.

[20] http://www.clearlyso.com/blog/5131/Leading%20childcare%20social%20enterprise%20secures%20landmark%20social%20investment%20deal

[21] http://www.cdfa.org.uk/wp-content/uploads/2010/02/CDFA-ICF-Report-2014.pdf

[22] http://www.cdfa.org.uk/about-cdfis/icf/

[23] https://www.cafonline.org/charity-finance--fundraising/borrowing/social-investment/caf-venturesome.aspx

[24] http://beanbagsandbullsh1t.com/2014/02/28/report-from-emerging-market/

Social Investment Tax Relief

Social Investment Tax Relief (SITR) is a tax break for investment in social enterprises introduced, following consultation, in April 2014.[25]

Its key provision is to allow individuals who invest in organisations with a 'defined and regulated social purpose' – charities, community interest companies and community benefit societies – to 'deduct 30% of the cost of their investment from their income tax liability' for the year the investment is made. As of April 2015,[26] the maximum eligible amount per investor per year is £1 million per investor while the maximum eligible investment in each organisation £5 million per and £15 million in total.

One significant difference between SITR and existing tax breaks is that, for the first time, it provides relief on unsecured loans as well as well equity investments. This is particularly significant for charities and Community Interest Companies Limited-by-Guarantee as these organisations do not pay dividends on shares, and are therefore unable to take advantage of existing tax reliefs.

In offering this option, SITR corrects an 'anomaly' whereby private companies could offer tax relief on high risk investments but regulated social organisations could not.

The Government's 'equalities impacts' assessment in the information pack published following the scheme's announcement[27] noted: "Investors are expected to be similar to those investing in the Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCT). Compared to the self-assessment population, those investors tend to be male, located in the south of England and have higher overall income levels."

SITR (like other tax reliefs) does not actively discriminate against less wealthy people but the process of taking advantage of the relief makes it difficult to access. Investors claim the relief through their annual tax return. Most people employed in salaried roles are not required to fill in an annual tax return. Furthermore, those with more money to invest are more likely to invest more money.

While this is not an argument against SITR – many social sector organisations will view it as a positive development that rich, men in the south England now have an incentive to invest in them rather than only in other, private businesses – it does highlight an additional challenge when attempting to create a genuinely *social* 'social investment market'.

SITR (like other tax reliefs) does not actively discriminate against less wealthy people but the process of taking advantage of the relief makes it difficult to access. Investors claim the relief through their annual tax return. Most people employed in salaried roles are not required to fill in an annual tax return and, feedback from social enterprise leaders suggest alternative ways of claiming relief are too complicated for many smaller investors to pursue.[28]

For those who imagine social investment to be in some way fairer or more democratic than conventional investment, the way in which SITR is likely to particularly favour the wealthy warrants further consideration. Can SITR be somehow opened up more widely to a more diverse and inclusive range of investors?

[25] http://www.civilsociety.co.uk/finance/news/content/17142/social_investment_tax_relief_to_be_worth_35m_a_year_by_2019

[26] http://www.pioneerspost.com/news-views/20141204/social-investment-tax-relief-strengthened-the-uk

[28] Discussion at SEUK event on SITR (24/03/15)

(v) Individuals:

The role of individual investors has sometimes been forgotten in the 'social investment market' as currently conceived. They are not included in market figures such as those in GHK's 2013 report, Growing The Social Investment Market,[29] which focuses only institutional investors. Meanwhile, there has been significant funding and support from government, BSC and the Big Lottery Fund into organisations and initiatives aiming to increase social investment by individuals.

Our report splits 'individual social investors' into two sub groups while acknowledging that these groups may overlap or have fuzzy dividing lines.

(a) Affluent individual investors as 'Angels'

High Net Worth Individuals (HNWIs) are generally considered to be people with 'liquid financial assets' (money they can use to make investments) in excess of $1,000,000. There is a further group with 'wealth available to invest in portfolios of between £50,000 and £1 million' that Nesta describes as 'the mass affluent'.[30] For the purposes of this sub-section they are described as 'affluent social investors'.

Affluent individuals may invest using a range of models but one model which has received much attention is as social 'angel investors'.[31] The UK Business Angel Association explain that: "An Angel investor makes use of their personal disposable finance and makes their own decision about making the investment."

The UK organisation most prominently involved in attempting to connect angel investors with social sector organisations looking for investment is Clearly So. Their Clearly Social Angels network described as 'the UK's first angel network dedicated to businesses that create positive social change'.[32]

Unltd's Big Venture Challenge (BVC) also plays a role here. A project funded by the Big Lottery Fund, it provides match-funding and supports social entrepreneurs to raise additional investment – with some of that coming from affluent social investors.

In December 2014, BVC reported that BVC-backed ventures had raised £770,000 from Angel investors between 2011 and 2013.[33]

What they want:

Affluent social investors will often be looking to make primarily commercial investments while also 'doing good'. 'Social Angels' will, like many conventional angel investors, also be keen to get actively involved in the running of the businesses they invest in. As Dan Lehner, former Head of Ventures at Unltd explained in 2013[34]: "Most of the angel investors ... know how the sectors work and almost all of them have taken a hands-on role in the company."

Attitude to risk and return:

Angel investments are arguably some of the highest risk investments available, which is why many angels seek to mitigate their risk by becoming directly involved in the running of the business.

In the mainstream business world, the high risk involved in angel investments is balanced by the prospect for high returns based on an 'exit' when shares in one or two high growth businesses in a portfolio are sold on at a profit. In social angel investing, these exits may not be so easy, particularly with certain social sector legal and ownership forms. Therefore, some social angels are understood to make high risk social investments because the social activity of the business is something they care strongly about and which they are willing to take into account when weighing up financial risk and return.

[29] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/210408/Social-Investment-Report1.pdf

[30] http://www.nesta.org.uk/sites/default/files/investing_for_the_good_of_society.pdf

[31] http://www.ukbusinessangelsassociation.org.uk/entrepreneurs/Introduction-angel-investing

[32] http://clearlysocialangels.com/about

[33] https://unltd.org.uk/wp-content/uploads/2014/05/UnLtd_Research_Publication_Number_8.pdf

[34] http://www.theguardian.com/social-enterprise-network/2013/sep/13/social-investment-angel-investors

Role in meeting demand from social sector organisations:
Affluent social investors are commonly regarded as a source of relatively large, relatively risky investments.

The City of London's report 'The role of tax incentives in encouraging social investment' noted that: "these individuals have sufficient wealth to be able to focus beyond purely financial returns, to encompass a social return, they have a route to market via Independent Financial Advisors (IFAs), and they have an identified, but as yet untapped, appetite for social investment."

But activity in the market to date has often focused on equity-based models and there has been less emphasis on encouraging affluent social investors to make other types of risky unsecured investment in organisations with a 'defined and regulated social purpose'.

Conclusion:
Social Angels appear to be limited in their role in meeting unmet demand as they are focused on larger investments and ones which are primarily equity-based.

(b) Other Individual investors
There are growing numbers of opportunities for less affluent individual investors to invest relatively small amounts of money is social sector organisations and early stage social projects, many of these innovative or tech-enabled. Nesta's 2014 report Understanding Alternative Finance[35] looks at 11 different emerging models of finance. Those which have particular relevance to social sector organisations seeking social investment include: Peer-to-Peer Business Lending, Equity-Based Crowdfunding, Reward-Based Crowdfunding and Community Shares.

As yet, there is limited information about the extent of 'social investment' taking place using the first three models. There are number of specialist social crowdfunding sites, such as Buzzbnk.[36] However it seems that only a handful of specifically social investment deals[37] – where crowdfunders have an expectation of some repayment – have taken place so far in the UK. Other initiatives include:

> Abundance[38] – a platform that offers individual investors the chance to invest in debentures offered by renewable energy projects. At time of writing, 1,786 investors have invested a total of £9,154,923.
> Ethex[39] – a platform that offers 'positive investments' that 'deliver social and environmental benefits, not just financial ones'. Investors can choose from a range of positive investments and invest or save from as little as £1.
> Allia, have set up the website Retail Charity Bonds[40] to: "provide charitable organisations with a simple and transparent structure through which they can access £10-50 million of unsecured loan finance via the retail bond market at affordable transaction costs."

35 https://www.nesta.org.uk/sites/default/files/understanding-alternative-finance-2014.pdf

36 https://www.buzzbnk.org/

37 https://www.buzzbnk.org/bonkofpants

38 https://www.abundancegeneration.com/

39 https://www.ethex.org.uk/

40 http://www.retailcharitybonds.co.uk/about/

But the alternative finance model that has perhaps been most successful in securing investment for social sector organisation directly from individuals is the model of Community Shares. As the Department for Communities and Local Government-funded Community Shares Unit[41] explains: "Community Shares refers to the sale of shares in enterprises serving a community purpose. This type of investment has been used to finance shops, pubs, community buildings, renewable energy initiatives, local food schemes, along with a host of other community based ventures." Understanding Alternative Finance reports that the market for Community Shares grew from £15 million in 2013 to £34 million in 2014.

41 http://communityshares.org.uk/

Attitude to risk and return:
Investors in Community Shares are, on average, investing relatively small amounts of money with relatively limited expectations of return. The average individual investment in a Community Share offer was £368. Only 24% rated 'the prospect of achieving

financial returns' as important or very important and 68 per cent of respondents said they had invested amounts that they felt they could afford to lose.

83% of investors in Community Share issues have an annual income of less than £50,000. This is the highest percentage for any form of investment-based Alternative Finance covered in the Nesta study, or in other words, the most inclusive and democratic of the new models of emerging finance.

Role in meeting demand from social sector organisations:
At £34 million invested in 2014, it is possible that Community Shares may already be the most significant source of 'cheap, risky, long term growth finance' available to social sector organisations. Although the focus is still on relatively large investments with an average of £174,286. Although the model has been used successfully to raise as little as £18,000.[42]

[42] http://communityshares.org.uk/case-studies/green-valley-grocer

Allia, Ethex and Abundance have yet to play a very significant role in enabling social sector organisations to access 'cheap, risky, long term growth finance in the tens – but not hundreds – of thousands'.

Conclusion:
Some emerging platforms provide opportunities for individual investors and play a significant and growing role in opening up the social investment market to small investors. But these are not yet well placed to meet unmet demand from social sector organisations. In other cases, community shares models aimed at individual investors seem to be playing a significant and growing role in meeting unmet demand.

(vi) Social Sector Organisations:

While this report primarily considers social sector organisations as the recipients of investment, it is also possible that they can play an increased role as social investors themselves.

Recent examples include:

> The Phone Co-op's £500,000 investment into HCT Group[43]
> The creation of The Emmaus Fund which enables local members of the Emmaus federation to access low interest loans administered by Emmaus UK[44]
> The launch of the Scottish Community Reinvestment Trust[45] – an organisation set-up to take on investments from Scottish Third Sector organisations and use the money to create financial products suitable for other Scottish Third Sector organisations

What do they want:
Social sector organisations will often need to invest with a view to financial return, security and liquidity, for instance. However, they may also choose to take wider social considerations into account depending on the context.

Attitude to risk and return:
Appetite for risk will vary significantly depending on context. However, with recent reports suggesting that the UK's 5,000 largest charities currently hold £17.4 billion in cash, many social sector organisations will have investable resources available and will not currently be earning significant rates of return on cash held at bank, for example."[46]

Role in meeting demand from social sector organisations:
'Backing ourselves' is a route that offers potential for social sector organisations to make better use of existing resources to meet unmet demand for social investment using a variety of different ideas. But to date there is little evidence that larger social sector organisations have yet to take forward these models beyond a few experimental models.

[43] http://www.thenews.coop/92351/news/community/the-phone-co-op-invests-in-public-transport-social-enterprise/

[44] http://www.emmaus.org.uk/news/1545_emmaus_shortlisted_for_two_social_enterprise_awards

[45] https://www.scrt.scot/about/

[46] http://www.thirdsector.co.uk/total-cash-held-uks-5000-largest-charities-rose-174bn-last-year/finance/article/1337025

(vii) Charitable Foundations

There are 63,000 charities in the UK that list grant making as one of their activities, there are estimated to be around 12,000 grant-making foundations in the UK. 900 endowed charitable foundations alone hold collective assets of over £48 billion and have an annual spend of £2.3 billion. [47]

What they want:
The Charity Commission published CC14 – Charities and investment matters: a guide for trustees in October 2011.[48] Within this guidance 3 key types of investment were identified:

> Financial investment – made to generate the best rate of financial return within the level of risk considered to be acceptable.
> Programme Related Investment (PRI) – investment made to further the charity's aims and therefore, in line with other use of assets for the same purpose, not bound by the laws relating to financial investment.
> Mixed Motive Investment (MMI) – where an investment could not be justified specifically as either financial or programme related investment. In making investments of this type trustees need to consider and justify the balance of social and financial return.

Attitude to risk and return:
Interpretations of the new CC14 rules are evolving. A lack of clarity, particularly around the requirements relating to Mixed Motive Investments, is causing nervousness on behalf of some trustee boards, and a reluctance to become involved in this type of activity "There is... evidence of increased nervousness and unwillingness among charity trustees to consider social investment for fear of the legal and financial risk". [49]

New Philanthropy Capital, in their paper "Best to Invest" [50] state that "The financial trade-off is complicated because social investments are generally made from the endowment and grants are generally made from income (generated by the endowment)"

Research by the Institute for Voluntary Action Research found that "One organisation that had attempted to use MMI felt that it was flawed conceptually and that it was not possible to split an investment between social and financial return. Another felt that the introduction of MMI 'arguably just confused things'". [51]

Others have a clearer view. As the ACF research explains, "Panahpur has since transitioned from a traditional grant-maker to a mission-related investor. It invests its capital across a spectrum of investments, with grants at one end which, while not making a financial gain, build the sustainability of the beneficiary organisations, through 'blended return' investments giving a financial and social return. At the other end are investments focused on maximising financial returns."

[47] The governance and financial management of endowed charitable foundations. (Richard Jenkins, 2012)

[48] CC14 – Charities and investment matters: a guide for trustees (Charity Commission, October 2011)

[49] Trusted and independent: Giving charity back to charities. Review of the Charity Act 2006 (The Office for Civil Society 2012)

[50] Best to invest? A funders' guide to social investment. (New Philanthropy Capital, July 2013)

[51] Charities and Social Investment. A research report for the Charity Commission (Institute for Voluntary Action Research, March 2013)

In the case of Programme Related Investment (usually taken from the grant expenditure budget within a Foundation), the financial return is generally a much lower concern although the aim is to at least recover what has been invested.

The requirement for financial return is hardest to define in the case of Mixed Motive Investment. In this case, the expectation of below market returns on an investment needs to be justified based on the enhanced social impact generated.

In recent years, low rates of return from mainstream investments have made social investment of this type more appealing. As NPC state in "Best to Invest" "many trusts and foundations have seen their returns on investments dwindle, making it harder to sustain grant making... In this context, social investment is an attractive prospect for funders who want to do more to support charities and social enterprises, in a way that has the potential to make both more sustainable in the long term". [52]

Role in meeting demand from social sector organisations:
ACF's research suggests that over the last decade approximately £100 million of risk capital has been set aside for social investment by foundations, of which around £50m has been committed to deals. [53]

ACF's survey report that 23 foundations are 'active in the market or have decided to enter it' with 10 large foundations responsible for over 90% of investments made so far. Esmee Fairbairn Foundation – the funders of the report – is the single biggest player in the market 'responsible for around 45% of the deals made' and, at the time the report was published, committed around £5 million towards social investment each year (compared to £32.5 million on grants).

Foundations' social investments include investments in social banks and SIFIs including Charity Bank, CAF Venturesome and Bridges Ventures, investments in Social Impact Bonds and loans made directly to frontline organisations.

ACF's [54] research suggests most investments are direct (rather than through an intermediary body), and are loans with an average value of around £100,000 over 5 years, compared to an average social investment value of £264,000.[55] Programme related investments are also generally unsecured, serving a further need for social sector organisations that do not have strong asset bases and may be refused other forms of finance on that basis.

Conclusion:
Fundamentally Foundations want to maximise their social impact whilst ensuring that trustees operate within their powers to invest. It appears that trusts are going some way to help meeting unmet demand for finance in the social sector but often working with and through SIFIs.

[52] Best to invest? A funders' guide to social investment. (New Philanthropy Capital, July 2013)

[53] Research briefing. Charitable trusts and foundations' engagement in the social investment market. (Association of Charitable Foundations, October 2013

[54] Ibid.

[55] https://www.cityoflondon.gov.uk/business/economic-research-and-information/research-publications/Pages/Growing-the-social-investment-market.aspx

Roundtables

Participants at out roundtables were not sure they understood what social investors wanted beyond 'their money back'.

Who social investors are and what they offer:
Some (primarily social sector organisations) had concerns about the emerging mix of organisations involved in social investment. Comments included:

> Most of the money is going towards asset backed safe bets – mainly what it's covering an awful lot of people earning very nice salaries and very proud of themselves for being in the social space
> Big Society Capital came to do an event a couple years ago – they turned up in crisp, expensive suits and talked about things like fund managers… there was a complete disconnect between the people in the audience and the product. They were finance people talking to Merlin banks in finance language. They were all talking a language they were comfortable with.
> There's a distinction between social lenders that have a social agenda and those who are doing it as CSR – they don't understand sector and not prepared to build relationship.

Other attendees had more positive outlooks on what some investors offered, and the growing interest from investors:

> The social banks operate the way banks used to, where you knew the person and it isn't about can the computer tick that box
> Credit unions an amazing signal of what communities can do without grant aid
> People are beginning now to realise they can invest in social purpose and that's where the capital is coming from.
> HNWIs are used to not getting anything back. When Scope did their bond, most of their investors said 'have the money back and re-invest it'
> We (Social Bank) lend our depositors money from £10 upwards. We're so successful in raising deposits we can't lend it all. Our ISAs sell out really quickly to people who just want to have more control over their money. Our depositors want their money back but it's a lot of people thinking differently.

What social investors want (Investors' views)
Social investors attending our roundtables offered a range of views both on what they want from social investment in a general sense and on specific deals:

> We want to make our money work – we don't make a clear distinction between grant and investment. We've done some repayable grants with no interest. We can have blurred rules on the approach. It's impact led, we'll look at anything.

> [From an umbrella body] Social investment is not a great paradigm shift, it's another tool in the toolbox. We had a tiny trust with a local focus wanting to invest in social impact bonds, it seemed absurd. A larger foundation did huge journey, lots of research and came up with the idea of doing some low interest loans. It comes back to the question of what you're trying to achieve.
> One of the roles of social investment is testing how good an organisation is. If someone takes on 100k and pays it back, they're probably quite a good organisation.
> There's a limited pot of money. We'd turned down organisations who just wanted to buy a building to sustain existing levels of activity.
> It's about engagement. Part of the lending process is to measure the social impact. There's a score card and we agreeing outcomes together.
> [Social Bank] application: An impact grid is filled in with the customer. We may allocate funds based on higher impact.
> Recycling grant funding is the most frequent pitch to trusts about why social investment is a good thing but for trusts but the big thing is whether it's a more appropriate way of providing finance for particular organisation.

What social investors want (social sector organisations and others)

The views from those seeking investment ranged from recognition of the approaches of particular investors, to scepticism about motives, to queries about the additional demands from social investors.

> Triodos are interested in social outcomes and impact and so they are happy to restructure etc
> CDFIs have to cover their costs.
> What's the motivation of these financiers? People clearing consciences.
> "lots of people will fund it once we've proved it works" "they're only wanting to back winners"
> The social investor approach is like going for a car loan and the bank saying: 'Can we see the car? Where are you driving it? Who's travelling in it?' – The bank just cares whether you repay the money rather than 'I need to know what the money's being spent on'.

Conclusions

Some key points emerging from this section are:

> The UK government as a social investor is not motivated by financial returns for itself but has most recently been motivated by the policy goal of creating 'a sustainable social investment market'.

> BSC exists to address market failure while also generating financial returns and operating under other constraints which limit its role in effectively meeting unmet demand

> Social banks which dominate the social investment space mainly provide finance in the form of asset backed, often quite large investments

> Many SIFIs seek to address unmet demand but the terms at which they themselves have attracted capital restricts their ability to meet demand from social sector organisations, whilst also covering their own costs

> Community Shares and other models which attract individual investors can attract finance on more generous terms but are often still quite large or only in certain sectors.

> There is to date a limited but growing role for social sector organisations to invest in each other

> Trusts and foundations also go some way to meeting unmet demand but operate under complex legal and other conditions

In conclusion, some investors don't seek to meet unmet demand. Those that do are either operating under complex constraints, with models that may never stack up, or are still in the early days, at the large end of the market

There is encouraging potential for sustainable models from individuals, trusts and the social sector itself. Particularly individuals, not least because they avoid the complexity of institutions government rules and fund models but also because of promise of SITR – but need to be aware of not just focusing on HNWIs.

A Social Entrepreneur's View:
Adam O'Boyle – Hub Ventures

I'm aware I may be generalising, perhaps at times unfairly, but, for me, the hype failing to live up to reality in some arenas of social investment is a talent issue that shouldn't be glossed over too uncritically.

The talents and skills of the people in any institution is a key issue. The big problem I see is that the many people making investment decisions are still locked within the mindset of the very large institutions from which they have come – regardless of sector. They often have sweet FA idea about what it means to run an organisation with a turnover of <£5m – the different market dynamics that social sector organisations face in terms of 'revenue streams', just what operating a start-up is like, funding gaps, how strategic planning is substantially different at that scale. Big city firms wouldn't go near the start-up size enterprises that the social sector is trying to support and therefore one shouldn't expect those from that background to understand the issues intuitively.

Silicon Valley seems a good analogy for a market that finds ways to allocate significant sums of capital to organisations with hardly any discernible/proven early-stage business model (like most social sector organisations?) Someone can likely prove me wrong, but the best VC firms (it seems to me – like Andreessen Horowitz or Founders Fund) are those where the principals / partners founded huge and successful companies. Show me a social investor who used to be a successful social entrepreneur and so can have a really intelligent conversation with potential investees about having been there and done that.

There is a challenge that social entrepreneurs don't typically 'get rich' but lots of VC firms only have a small core of founders' money, backed by other investors. So you need not be massively rich to have a lot of money to invest. Crucially they are held accountable though – bad investments will lose them money. At a SIFI or Foundation?

I also get the feeling that in a good VC firm the principal is making the decision – and is also doing a good deal of the venture hunting. Whereas with SIFIs, you go through a tonne of committees before you get to a decision-maker and then the final decision is still made by an investment committee with people that might only be doing their investing part-time (who you might not even meet). Venture Capitalists are professionals, venture philanthropists and social investors are relative amateurs. In the VC world, investing in new ventures is the full-time job of the person who makes the investment decisions, and they work at it. Or at least it has been their full-time job, they have grown up in the space, they have lived it and breathed it. It might even be a good chunk of their wealth. This is not some sideline, nor some career change, a part-time secondment or something where irrespective of success or failure, you still get paid at the end. Although venture philanthropists and social investors often have well qualified staff teams, most social investors and venture philanthropists operate where the decision making power still sits with people who do their philanthropic activities as a sideline, on boards of trustees, or part-time as social investment advisors. Investment committees are typically populated by 'private sector expertise'.

I was struck speaking to a very successful social entrepreneur who has a big funder on their board and the funder was saying: "yeah we can get you money for that'. The social entrepreneur thought: "no, you can't, because you'll go back to the office and I'll have to fight through all your underlings and then your board and the idea will die a horrible death."

I want to look into the whites of the eyes of an investor and have them tell me my business is crap – not one of their team tell me that I couldn't fill in their box ticking exercise. I think I could name you 5 or 10 people – successful social entrepreneurs – who if they were allowed to make investment decisions and sit on the boards of their investees could transform the social investment market. They just know how to fix stuff for real, rather than advise you to attend another training session or live in some hypothetical world where lots of social enterprises are magically going to scale in the next two years.

The market needs a mixed landscape of talent – many founders would make terrible investors I'm sure – but it seems too concentrated in the wrong ways at the moment. And it leaves a lot of organisations with too little respect for those that have funded them along the way. Either investees are ungrateful, or we have a problem.

Section

4 Can Social Investment, as currently conceived, meet social sector need?

52 This section considers the extent to which the current predominant approach to social investment in the UK is meeting the needs of social sector organisations, and the extent to which it is likely to do in the future.

In doing so, we focus primarily on the conception of social investment championed by the UK government and government-backed social investment wholesaler, Big Society Capital (BSC).

As previous sections make clear, the UK government and BSC are only two of many participants in social investment in the UK. Many individuals and organisations were doing social investment before BSC was created and many have continued to do so since 2012 without receiving (or seeking) BSC funds.

The UK government and BSC are, however, the two biggest players in the attempt to create something called 'a social investment market' in the UK. Between them they have allocated hundreds of millions of pounds of public money, plus significant funds from other quasi-public stakeholders such as Big Lottery Fund, in support of this agenda.

Before BSC's launch in 2012, the extent of activity in what was described as 'the social investment market' in the UK was estimated at £202 million. However the vast majority of that total was lending from the four main 'social banks'. These banks have long track records of, and expertise in investment into social sector organisations but they are not seeking to make 'unbankable' investments.

The estimated size in 2012 of that part of the market which was set up to make investments in response to market failure was around £36 million. As a £600 million organisation entering a £36 million market, BSC was in a position to fundamentally reshape that market.

This section looks at the extent to which the market being created is succeeding in meeting the needs of social sector organisations unable to access finance from mainstream markets.

Building a market vs. supporting social sector organisations

Firstly it is useful to consider what some of the key players in the social investment market say it is for. Politicians have been quite explicit about their aspirations. For one of many examples, speaking at the launch of social investment wholesaler, Big Society Capital (BSC), in April 2012, the then minister for civil society, Nick Hurd explained that: *"This is a time when we need to be doing more to back our social entrepreneurs. For many years, charities and social enterprises have been telling government how hard it is to access long-term capital. We have listened and within two years have delivered a new institution that will make it easier."* [1]

Minister and civil servant leaders were explicitly looking to 'make it easier' for social sector organisations to access finance.

Section 1 above suggests that most social sector organisations seeking larger amounts of finance find it relatively easy to access finance from mainstream providers already. Therefore, it seems likely that meeting the needs of social sector organisations at the smaller, riskier end of the market for finance would be a priority in making things easier for the demand side

Given that Section 1 also suggests that a significant percentage of social sector organisations that receive offers of finance turn the money down because it is not offered at an affordable rate, providing cheaper money might be another focus.

Developing a diverse, well-capitalised, sustainable market

The creation of BSC was a policy decision taken by the UK Government. Now operating as an independent organisation, BSC describes its role as supporting the development of: *"A vibrant, diverse, well capitalised and sustainable social investment market in the UK, through which charities and social enterprises can access appropriate and affordable finance and support to grow their positive impact on society."* [2]

[1] http://www.theguardian.com/society/2012/apr/04/david-cameron-big-society-fund

[2] http://bigsocietycapital.com/about-big-society-capital

This does not amount to a commitment to meet all the demands or needs of social sector organisations, as determined by those organisations. But the dual motivations of creating a market that is 'sustainable' and which also offers access to 'affordable finance' provide clear potential for in-built conflict. Investees have to be able to afford the money but for a sustainable market to exist, players in the market i.e. investors need to earn sufficient revenues to cover their costs.

This begs the question of whether, if potential sustainable market is possible that works well for investors and investees, why did it not exist already when BSC was created? Was this because of failure of imagination within either or both the financial markets and the social sectors?

Why else has the market failed when it needn't? It requires no little confidence from policymakers to create a multi-million pound response to market failure which is under orders to create for itself a viable long-term future.

Nevertheless, even if this £600 million *leap of faith* is the right one, Big Society Capital now has to face the challenge of what to do in situations where one of its operating principles is at odds with the other.

Crowding in

One of BSC's key strategic objectives, perhaps not widely understood, is that while BSC has around £600 million to invest, its investments in SIFIs' funds are intended to 'crowd in' additional funds from other investors. Its investment policy states[3]: "BSC aims to build the social investment market through leveraging in additional capital in to the sector alongside its commitments. We look for investments into investment intermediaries to be matched on a 1:1 basis; over the long-term we have an aspiration of a 4:1."

[3] http://www.bigsocietycapital.com/sites/default/files/pdf/BSC%20investment%20policy.pdf

This approach is vital to creating what BSC perceives to be a 'well capitalised and sustainable social investment market'. However, it does also mean that the organisation can, unless it makes a specific exception, only invest in funds that other investors are also prepared to invest in. Here, the aim of creating a well capitalised market can take priority over the aim of insuring the funds invested offer 'affordable finance'.

Growing in demand due to public sector outsourcing

Initially, it seemed that policymakers, politicians and social investment leaders hoped that the potential for conflict between BSC's two primary drivers would be reduced in part because the development of the social investment market was coinciding with changes in the market for outsourced public services. This would mean that larger numbers of social sector organisations would be interested in, and able to, take on repayable finance at 'sustainable' levels.

The 2012 BSC-commissioned Boston Consulting Group report The First Billion[4] estimated that demand for social investment could see that market grow from £165 million worth of deals in 2011 to *'as much as £1 billion by 2016'*. It made this prediction based on: *"a series of favourable trends: Growing outsourcing of public services to private and social providers; a new statutory requirement for commissioners to consider social value when awarding contracts; and a shift towards higher-risk models of payment, such as payment by results... "*

[4] http://www.bcg.com/expertise_impact/PublicationDetails.aspx?id=tcm:12-115600&mid=

This implies a significant growth in demand from social sector organisations based on changing (public service) market conditions. However, the authors' expectations were also based on the belief that, when compared to commercial investors, social investment finance intermediaries (SIFIs) would have an increased ability to offer Social Sector Organisations a combination of benefits over and above what was on offer from mainstream finance providers, including some (or all) of: social sector expertise, higher risk investment and cheaper money. Presumably, that expectation was partly based on the belief that the BSC would invest money in SIFIs on terms that made this possible.

Your sustainability is our sustainability
BSC is also set up to become a sustainable institution itself with aspirations for the wider market dovetail and an attitude towards its own sustainability, something stated in its investment policy: "We aim to balance our mandate to develop the social investment market and create positive social outcomes with the need to generate long-term financial returns. We ourselves need to ensure that we are sustainable as an organisation and that our capital is preserved."

BSC then, and others charged with developing the social investment market, have spent recent years attempting to solve the problem of how social investment can meet demand from social section organisations' that is not currently met by commercial markets whilst also developing a viable commercial model. The next part of this section assesses the progress made so far.

What do we mean by sustainability?
Sustainability does not seem like an especially complicated word to understand. Oxford Dictionaries define it as: "Able to be maintained at a certain rate or level".[5] However, the notion of sustainability for social sector organisations and within the wider provision of social goods is ambiguous and highly contested.

In the UK voluntary sector, particularly in the period since 2000, social enterprise-based trading activities have often been promoted as the 'sustainable' alternative to income generation through 'traditional' models of grant funding and donations.

The broad idea is succinctly expressed by social enterprise leader Graeme Oram[6] in a 2013 article for Pioneers Post: "… far too few socially enterprising ideas reach transformational levels of scale. Equally, too many remain grant reliant and unsustainable."

Social investment is regarded as a tool to help organisations become more sustainable. 'Charities and Social Investment'[7], a 2013 IVAR report for The Charity Commission, explains the perceived role of social investment in supporting charities to become more sustainable: "It is thought by some that social investment could play a significant role in capitalising charities, which could, in turn, help charities to achieve their objectives by making them more sustainable."

The suggested rationale for this belief is: "that social investment has the potential to encourage innovation, enable social impact and support income diversification at a time when the need for alternative finance is likely to rise."

The problem with sustainability in this context is that it is often taken to mean 'commercially viable through trading income'. This makes complete sense if a social organisation is selling products or services in a commercial market, competing against mainstream businesses.

However, as *some* social investment leaders have noted,[8] many social organisations operate in situations of market failure, where social needs are not currently being met by mainstream businesses.

There is no evidence for, or logical reason to assume that trading income will necessarily be the most sustainable form of income to support the provision of a social good in any given situation. As argued elsewhere,[9] a sustainable business model is the one that is most likely to be sustained.

5 http://www.oxforddictionaries.com/definition/english/sustainable

6 http://www.pioneerspost.com/news/20130419/skoll-look-back

7 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/284227/social_investment.pdf

8 http://iipcollaborative.org/lessons-learned-from-establishing-the-worlds-first-social-investment-bank/

9 http://www.theguardian.com/social-enterprise-network/2013/jul/16/mythbusting-trading-sustainable-grants

Hoist by sustainable petard
Ironically, and perhaps not that surprisingly on reflection, the quest for sustainability in the social investment market comes up against the same barriers as those faced by the organisations the market has been set up to help.

It is not clear, but of course not out of the question, that social investment can meaningfully tackle market failure while itself being commercially sustainable. Some argue that one of the main market failures in access to finance for social enterprise is one of misconceptions of risk. With the right models in place, maybe the market can stack up?

On the other hand, it may be possible for social investment to become sustainable based on demonstrating the social value it delivers and receiving non-commercial support as a result.

Examples (all of which already exist in some form) include:

> tax breaks
> grant funding to support 'investment readiness'
> grant funding to subsidise investments directly
> subsidies for social investors
> investors accepting reduced returns or the possibility of negative returns

It may be that the key to building a 'sustainable' market is for organisations and individuals to recognise the social value of social investment (or individual social investments). On this basis, it might be possible to produce the right mixture of ongoing subsidies and distinctively social approaches to investment to enable the market to sustain itself.

The 'market' before BSC
Since the launch of BSC, there has been a significant influx of resources into what BSC and the government regard as being the 'social investment market'.

Before that influx of resources, the existing market offered a range of products, some of which were designed to meet the needs of social sector organisations unmet by 'mainstream' finance. Others, particularly those offered by the social banks, were modelled along 'mainstream' lines with similar products at similar prices but by lenders with interest and expertise in the social sectors. How much of what was on offer was intended to meet the demand identified above for 'cheap, risky, long term growth finance in the tens – but not hundreds – of thousands'?

The 2013 ICF GHK report, Growing the Social Investment Market,[10] surveyed the market in 2011/12. That year saw 765 deals made by 29 SIFIs investing £202 million in total.

Of that, 82% of that was secured loans from the four big social banks – 229 investments with an average size of £723,000 and 90.2% of the total funds invested were in secured loans.

On the other hand, a significant proportion of the deals by number were far smaller, going at least some way towards meeting demand for finance 'in the tens of thousands' of pounds.

[10] https://www.cityoflondon.gov.uk/business/economic-research-and-information/research-publications/Pages/Growing-the-social-investment-market.aspx

Nine (relatively) large SIFIs invested only £30 million made up of 427 deals worth an average of £71,000. The remaining 16 smaller SIFIs invested a total of £5million between them across 109 deals, with an average deal size of £56,000.

How much did this capital cost? Large SIFIs charged an average of 7.1% on secured loans and 7.6% on unsecured debt. Small SIFIs charged 7.9% on secured debt and 9.3% on unsecured.

This evidence suggests that the pre-BSC, the social investment market did not provide significant amounts of 'cheap, risky, long-term growth finance in the tens – but not hundreds – of thousands'.

The total value of all unsecured finance being provided (in various forms) was under £20 million but the evidence does not suggest that, on average, it was provided at rates that organisations would regard as 'cheap'.

Table 1	**Value and volume of the UK social investment, 2011/12, by SIFI type**					
Type of SIFI	**Total value of investments**	**% of total value of investments**	**Total no. of investments**	**% of total no. of investments**	**Average investment size**	**Range of no. of investments**
Social bank	£166m	82%	229	30%	£723K	15 to 97
Large SIFI	£30m	15%	427	56%	£71K	3 to 170
Small SIFI	£5m	3%	109	14%	£56K	1 to 30
All investors	**£202m**	**100%**	**765**	**100%**	**£264K**	**1 to 170**

Growing the Social Investment Market, Table 4.1 (P. 20)

Table 2	**Types of social investments in 2011/12 (value and as a proportion of total value invested), by category of social investor**					
Type of investor	**Secured loans**	**Unsecured loans**	**Quasi-equity**	**Equity**	**Social Impact Bond**	**Other**	**Total**
Social banks	£165.5m	£0.3m	£0.0m	£0.0m	£0.0m	£0.0m	£165.8m
Large SIFI	£15.6	£8.8m	£0.1m	£2.6m	£1.1m	£2.1m	£30.3m
Small SIFI	£1.3m	£1.4m	£0.2m	£2.1m	£1.0m	£0.0m	£6.1m
All investors	**£182.4m**	**£10.5m**	**£0.3m**	**£4.7m**	**£2.1m**	**£2.1m**	**£202.2m**
Social banks	99.8%	0.2%	0.0%	0.0%	0.0%	0.0%	100%
Large SIFI	51.5%	29.0%	0.4%	8.5%	3.6%	7.0%	100%
Small SIFI	21.9%	22.7%	3.3%	34.9%	17.1%	0.1%	100%
All investors	**90.2%**	**5.2%**	**0.2%**	**2.3%**	**1.1%**	**1.1%**	**100%**

Growing the Social Investment Market, Table 4.2 (P. 23)

Grant dependency among SIFIs
One big problem with the situation before BSC's creation when considering the ambition to develop a 'sustainable social investment market' was that, whether or not the existing market succeeded in meeting (some) unmet social sector demand, it was not doing so on a sustainable basis.

The GHK report noted that: "Of the eight larger SIFIs (investment over £1 million) who provided data, half were covering their social investment costs through earned income (and in some cases generating a considerable surplus), and an additional one almost achieved sustainability in 2011/12."

Furthermore, "One large SIFI was only able to cover 18% of its social investment costs through earned income". The situation for smaller SIFIs was even worse: "Of the seven smaller SIFIs (investment under £1 million) who provided data, two were able to cover their costs, and five were not."

One section of the market was 'sustainable' – the social banks. These were 'understood to be operating on a sustainable basis' but these banks were offering secured loans worth on average £723,000.

So, when BSC launched with a mission to build the UK social investment market, not only was the majority of the money in the existing market not being made available as: 'cheap, risky, long term growth finance in the tens - but not hundreds - of thousands' but the majority of the organisations operating in the market were themselves 'unsustainable'.

Figure 1 – The operational sustainability of selected SIFIs who make investments, 2011/12
Operational sustainability, In %

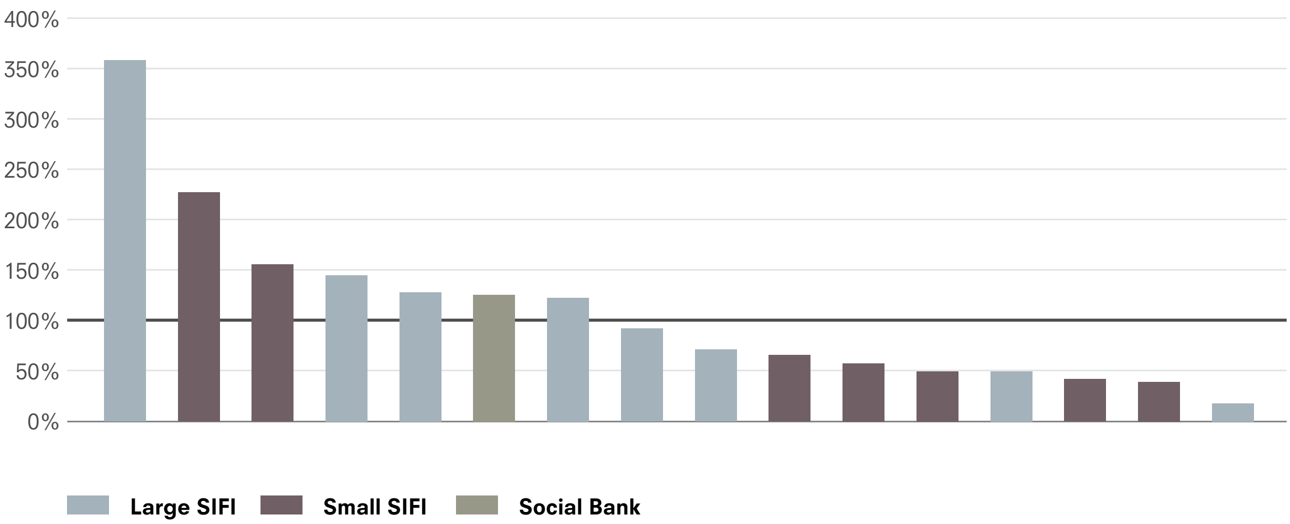

Figure 4.8, page 28

View from our roundtable discussions

There was not one single coherent view emerging from our roundtables on the ability of the social investment market to meet the needs of social sector organisations currently unmet by mainstream finance. But our discussions did suggest that a significant majority of our roundtable attendees – a diverse mix including representatives from social sector organisations, SIFIs, support organisations and independent consultants – felt that the market was not currently relevant to the majority of social sector organisations seeking finance.

Views on what the market currently offers

There was significant concern that many of the investment products currently on offer are too big or too expensive for most social sector organisations:

> Most start-ups need equity, grants, someone with very patient pockets. There is significant demand from organisation that may be able to deliver returns at less than £150,000. Between £25,000 and £150,000 is the sweet spot.
> Our organisation went to all the social investment intermediaries – we were told we were very investable but weren't offered anything affordable.
> CDFIs are very expensive
> If you're offered rates of 11%-14% it's better to do it on your credit card
> We see plenty of second rung finance available but no first rung – the key social investors only back winners and safe bets. First rung finance need only be small amounts – £10,000s rather than £100,000s
> Interest rates of 9% -14% are the business equivalent of going to Wonga
> Mainstream banks begin to look like the more likely lenders than social investors

Mismatches

Many discussions touched on the broad mismatch between what the market is offering and what social sector organisations need. This view was expressed by many SIFI representatives as well as those from social sector organisations and support bodies:

> For vast majority of people this is irrelevant
> Products are not fitting the sector
> Organisations want capital and finance at cheapest cost available
> They're not looking for capital, they're looking for money – organisations end up applying for investment when they need grants (or increased revenue)
> People assumed that BSC was going to be a source of grants that would take their problems away
> There's a complete disconnect between the audience and the product

Cultural differences

In many discussions there was a feeling that SIFIs and BSC do not understand the culture of social sector organisations. Others felt that cultural change in the social sector, partially driven by social investment, might be a good thing.

> In general, the market is driven by financiers who know about clever financial models - driven by providers rather than customers.
> BSC turn up in expensive suits and talk about things like fund managers
> The suits and trusts based in London don't see life beyond the North Circular
> Feeling that lots of social investment is in London and is "remote" and "the same old people"
> The culture of the sector means social investment doesn't work.

Growing pains

There was widespread acceptance that the 'the social investment market' is relatively new coupled with a mixture of, in many cases, optimism that it will become more useful as it develops. In some cases, there was a sense that viewing social investment as 'a market' is a bad idea.

> The social investment market worldwide is an immature, developing market.
> Conventional financial markets have a wide range of infrastructure which doesn't exist in the social sector.
> Change is happening but isn't coming fast enough: long term patient capital is becoming more prevalent not just in the social sectors but in private business
> The social investment marketplace doesn't exist.

Emerging questions

The biggest overarching questions emerging repeatedly – worded in a wide variety of different ways – were:

> If banks and social investor could offer the same financial terms, what would make a social investor more attractive?
> Finance markets have developed to support profit making businesses – how appropriate is it that we expect these markets to support social organisations in transition?
> For a smaller group of business-like organisations, social investment is very relevant – are there enough to make it a viable marketplace?

Some views from our online survey

The views captured in our online survey are as diverse as those emerging from our roundtable discussions. The following are primarily responses to the questions: 'Have you ever sought/applied for social investment? If so, why? If not, why not?' and 'What have your experiences of the current UK social investment market revealed about the availability of the kind of investment your organisation needs?'

1. Many respondents had not engaged with the market sufficiently to offer a view but of these who had some felt that the size of deals or cost of money was wrong:

"Sums too large" – Charles Rapson, Colebridge Enterprises Ltd

"We are investment ready but are unlikely to take up loan offers. We do not, and are not able to, secure the type of long-term high income contract that appears to typify the social enterprise sector. As such the ability to taken on repayable loans with rates of 6-12% is not viable." – Tony Jones, Landlife National Wildlife Centre

"Most of the minimum amounts available are far too large" – Online survey respondent

Others made points illustrating the fact that, in some cases, social sector organisations are not suitable candidates for social investment because of the nature of the markets they operate in:

"Have considered it - main issue is that whilst I think we've choices in gaining investment I'm not convinced about the business opportunities. In public sector commissioning, work is increasingly split between giant and tiny contracts. Contracts that are about the right size are contingent on reducing demand for services in the short to medium term and I don't think there's any robust evidence that this is actually possible and if it is it's impossible to attribute success. Frankly, I don't think there's enough market demand to justify investment." – Online survey respondent

"My clients are SME charities. They are not retail charities. They are highly dependent on trust fundraising. They need an alternative source of long term funding to deliver their outcomes. Initial investigations reveal that there are limited options available to them." – Renae Mann, Inclusive Change Consultancy Ltd

2. Some noted the lack of examples of investment so far:

"Difficult to understand, need to see practical examples limited availability in Northern Ireland and perhaps outside London. Can it operate in a small market? Takes time and promotion to get people enthused" – Bill Osborne, VSB

3. Others had received investment and were optimistic about more being available to investable organisations:

"We have now secured two rounds of social investment. We are a housing based charity and therefore investment is secured against the property assets. Achieving the investment deals have been relatively straightforward although formulating the right legal agreement was a tortuous affair once lawyers became involved as this was clearly new territory for them." Ashley Horsey – Commonweal Housing

"Yes, [we have received investment] to fund the scaling up of Swarm apprenticeships. There is plenty of investment out there, but frustration amongst investors (particularly private investors) at the shortage of investment ready enterprises." – Robert Ashton, Swarm Apprenticeships Ltd

In his response to another question in the survey: 'How could the UK social investment market be made more relevant to a wider range of charities and social enterprises?' – Robert Ashton expressed the view that: "It is already highly relevant. Tension exists on the demand side because not enough social enterprise and charity Boards are ready to accept the need to be businesslike & sufficiently focused on profit. Interestingly, if you listen to Big Society Capital, they are more interested in what an organisation does, than what it is. This means traditional 'for profit' structured businesses can, if they demonstrate social impact, benefit from social investment. This, together with SITR, should drive reform through the sector, replacing 'tin-shakers' with 'deal makers'. Government's move from grant towards PBR contracts supports this trend"

↗

Navigating the market

A 2014 Design Council report, *Social Finance in the UK: designing the experience for ventures,* [11] commissioned by The Cabinet Office, addresses the problem that: "In the emerging and fast growing market for social finance, ventures seeking investment can struggle to identify and obtain the funding and support that is right for them."

The report identifies 7 'key needs' that would need to be addressed to improve the 'user experience' of social ventures looking to access funding:

1) The middle stage gap (ventures struggle to fund themselves when they have an initial service or product, but aren't yet ready to move towards scale or rapid growth)
2) Lack of skills crossover between funders and ventures
3) Ventures feel funding criteria and decisions are opaque
4) Wasted time on applications
5) Language barrier for 'not social enterprise' (some ventures are excluding themselves from sources of funding they perceive as 'not for them' because they don't consider themselves to be social enterprises) [12]
6) Understanding different funding routes upfront
7) Repayable finance seen as too risky for ventures

Our discussions with social sector organisations, and also with many staff at SIFIs and support organisations, suggest both significant confusion about what the social investment market has to offer, and frustration about the process of applying for investment. While this is particularly true amongst organisations who do not receive investment, it is also true for many who ultimately are successful.

What is not clear is whether confusion about what is available and inefficient processes are, in themselves, a key reason why the social investment market is struggling to meet demand for Social Sector Organisations or merely an aggravating factor.

[11] http://www.designcouncil.org.uk/knowledge-resources/report/social-finance-uk-designing-experience-ventures

[12] The small sample of organisations interviewed for this report (20) includes a significant over-representation of both 'for-profit' social ventures (50%) and London-based organisations (65%). One 'key need', no.5, is particularly relevant to that group but the other 'needs' are consistent with feedback from Social Sector Organisations at the Commission's roundtable events and online survey.

The market since BSC's launch. Part 1 – Funds

BSC's 2nd Annual Report,[13] published in May 2014, reports that as of 31st December 2013, the organisation had made commitments to invest £149.1 million, primarily in funds which SIFIs would then invest in Social Sector Organisations.

Of the money committed by 31st December 2013, £48.1 million had actually been made available to SIFIs at that time, based on the fact that they had secured matching funding from elsewhere. These commitments suggest significant changes to the volume of finance available for some products: in particular unsecured loans and equity finance.

While the total value of unsecured loan deals in the entire social investment market 2011/12 was £10.5 million, BSC committed £15 million to new SIFI Social and Sustainable Capital's Third Sector Loan Fund (TSLF) as part of a total £30 million fund that offered both secured and unsecured loans.

[13] http://www.bigsocietycapital.com/sites/default/files/BSC_AR_2013.pdf

BSC also committed £10 million to FSE Group's Social Impact Accelerator Fund (SIA) which offers loans to what BSC CEO Nick O'Donohoe describes as: "those who do not qualify for traditional secured lending."

However, and critically, these funds offer deals starting from £200,000 (SIA) and £250,000 (TSLF) respectively.

Despite the fact that most cannot issue equity, existing research cited in Section 1 suggests that social sector organisations are already marginally more likely to access equity finance than other SMEs. Issuing equity is probably the easiest way of securing risky, long-term growth finance for organisations that are able to do so.

During 2013, Big Society Capital committed investments to at least two funds offering equity investments: an £8 million investment in Nesta's £25 million Impact Investment Fund and £10 milion into the £30 million Impact Ventures UK fund managed by LGT Group.

The Nesta fund offers 'equity investments, revenue-sharing arrangements and loans' of between £150,000 and £1 million, and has primarily focused on equity investments. Impact Ventures UK doesn't specify its investment apparatus but has made so far investments ranging from £300,000 to £2 million.

The first £21million
A more recent snapshot of the overall picture is provided in an update from Nick O'Donohoe, published on the BSC blog in January 2015.[14]

The update estimates the cumulative drawdown from BSC and its co-investors during the organisation's first three years of operation at £104.2 milllion, with the majority of that, £75.7 million being drawn down in 2014.

Of that money, £36.2 million is BSC money, of which £22.9 million was drawn down in 2014.

These numbers suggest that the drawdown of BSC money and the additional investment 'crowded in' to 'the social investment market' with BSC's matching investment is now increasing. However it is not clear how much of this investment is meeting previously unmet demand from Social Sector Organisations.

The update explains that just 20% of the cumulative drawdown of BSC money – an estimated £7.2 million – has been invested in: "asset-locked organisations (charities, community interest companies, community benefit companies, and companies limited by guarantee), and co-operatives."

If 'asset-locked organisations' received a similar percentage of the total £75.7 million investments drawn down from BSC-backed funds, the total would be around £15 million in 2014 and around £21 million in total.

The market since BSC's launch. Part 2 – Investment readiness
During the evolution of the social investment market pre-2012, investments in social sector organisations through government funds such as Futurebuilders[15] and the Department of Health's Social Enterprise Investment Fund[16] were either preceded by, or combined with, a mixture of grant-funding and state-funded business support designed to help organisations reach the stage where they were able to take on and repay a loan.

14 http://www.bigsocietycapital.com/blog/january-update-big-society-capital

15 http://www.futurebuilders-england.org.uk/about-us/

16 http://www.sibgroup.org.uk/past-funds/seif/

The launch of BSC – with its aim to create a sustainable social investment market – has seen that support function splits off from the function of investment with the promotion of the concept of 'investment readiness'.

The 2012 Big Lottery-Fund report, Investment Readiness in UK [18], defined 'investment readiness' as: "an investee being perceived to possess the attributes, which makes them an investible proposition by an appropriate investor for the finance they are seeking."

The report found that, from the perspective of investors: "Financial skills of all kinds were the most common barriers to securing investment" and "Organisations often approach investors too early without securing the fundamentals of their business plan"

The £10 million Investment and Contract Readiness Fund (ICRF)[19], launched by the Office of Civil Society in May 2012 and managed by The Social Investment Business [20], provides: "Grants between £50,000 and £150,000" that "will be available on a rolling basis to ambitious social ventures who will go on to raise at least £500,000 investment, or who want to bid for contracts over £1 million."

ICRF is not a fund designed to support Social Sector Organisations in a general sense.[21] It has the aim of supporting large social sector organisations to grow their businesses whilst also providing an income stream for consultants and SIFIs that acts as subsidy to the social investment market.

The ICRF has been successful in the sense that many of the organisations supported through it have already secured either investment or contracts. In November 2014, the Cabinet Office announced out that [22]: "So far, 51 charities and social enterprises have won deals worth £117 million with help from ICRF grants worth just £4.5 million - £26 for each £1 of grant."

Of the 'Top 10' recipients of funding listed by Cabinet Office, 7 have secured contracts and the total value of those contract £64.36 million represents more than half the total value of all deals secured by funded organisations.

The Social Investment Business estimate [23] that a total of 31 contracts and 22 investments have been secured by funded organisations – a small number of organisations have secured both contracts and investments. Some ICRF-funded organisations have received investments from BSC-backed social investment funds but a more detailed breakdown is not currently available.

Big Potential [24], a £10 million fund launched by Big Lottery Fund in February 2014, is designed to reach some of the Social Sector Organisations that ICRF does not. It is based on the same 'Approved provider' model as ICRF but provides smaller grants to organisations looking to raise between £50,000 and £500,000.

In general, investment readiness support aims to help social sector organisations who are close to being able to take on relatively large investments from social investors to get to the point where they can do so.

For some, that is what they want to do and evidence so far suggests that many organisations are finding investment readiness support to be useful, however it is not clear:

a) the extent to which social sector organisations who would like business support would chose 'investment readiness' if support not linked to investment was available
b) whether most organisations successfully supported to become 'investment ready' are choosing to seek investment from the social investment market rather than from main stream investors

18 http://www.thinknpc.org/publications/investment-readiness-in-the-uk/

19 https://www.gov.uk/government/policies/growing-the-social-investment-market/supporting-pages/supporting-the-development-of-more-social-ventures

20 http://www.sibgroup.org.uk/beinvestmentready/

21 One social investment leader estimated in email correspondence that an organisation would need to have a turnover of at least £3.5million to seek ICRF levels of investment

22 https://www.gov.uk/government/news/investment-and-contract-readiness-fund-helps-social-ventures-win-business-worth-117-million

23 Email correspondence

24 https://www.biglotteryfund.org.uk/global-content/press-releases/england/270214_eng_sib_fund-to-get-sector-investment-ready

Missing pieces of the jigsaw – social enterprise support
2000-2010 was a time of growing UK government support for what was regarded as an increasingly important social enterprise sector. The state provided (subsidised forms of) social investment through funds including Futurebuilders, The Adventure Capital Fund and the Department of Health's Social Enterprise Investment Fund but also provided substantial funding for social enterprise development with no specific link to repayable finance.

This funding included national grants to umbrella bodies including Social Enterprise Coalition / Social Enterprise UK, Social Firms UK and Co-Operatives UK. While much of this funding was for advocacy rather than business support and these organisations continue to exist, albeit with reduced or altered service provision, the most significant change has been in regional support.

Supporting social action at a local level
In 2010, there were nine regional social enterprise support bodies in England funded primarily funded by Regional Development Agencies (RDAs). Many of these bodies successfully used their basic funding to lever in additional funds from elsewhere."

While, the incoming coalition government may not have taken a specific decision to abolish regional social enterprise support, that has been the effective result of their actions in scrapping the RDAs.

Of the English regional social enterprise support bodies that existed in 2010: 3 have closed, 2 more are now skeleton operations and 1 has been absorbed into a housing association. The other 3 have survived by focusing some or all of their activity on social investment. The 6 organisations that continue to exist in some form continue to do good work but in most cases they are not able to offer social enterprises anything like the level of support they offered before the end of RDA funding.

This has coincided with dramatic reductions in non-specialist support for social enterprises provided either by Business Link (from the business side) or local CVSs (from the voluntary sector side. Now Business Link no longer exists and CVSs are mostly struggling to remain in business. Not all social enterprises found any of this support useful but many did.

Private sector-backed schemes such as Business in the Community's Arc programme and Deloitte Pioneers have emerged to fill part of the gap in provision but they are not of a sufficient scale to replace the services that have been lost.

Building the pipeline
It may not be a like for like re-allocation of the same funding but, taken as whole, since 2010 the UK government has overseen a huge decrease in funding for infrastructure support for social enterprises while at the same pouring significant resources into support for the social investment market.

Cabinet Office has supported:

> the £10 million Social Incubator Fund
> the £10 million Investment and Contract Readiness Fund
> the development Social Impact Bonds with significant civil service resources

DWP and DCLG have provided similar support for the SIB by creating specific funding streams devoted to them.

Beyond government, the 2010-14 period also saw Big Lottery Fund shift their focus from support for wider charity and social enterprise infrastructure to allocate significant resources to the development of social investment including:

> £11.25 million worth of funding to a single SIFI, Social Finance, to develop the Social Impact Bond (SIB) model, with £6.25 million of that going towards subsidising one SIB in Peterborough [25]
> £6 million to support new approaches to social investment through the Next Steps fund [26]
> £8.5 million funding for Unltd's Big Venture Challenge programme
> £10 million in investment readiness funding through the Big Potential programme
> £60 million funding (in partnership with Cabinet Office) to subsidise more SIBs through the 'Commissioning Better Outcomes' fund [27]

The cost of ensuring the continued existence of regional social enterprise support in all nine English regions, with a core budget of £200,000 per year for 5 years would have been £9 million.

While many of the programmes designed to support the development of the social investment market have provided wider support to social enterprises, this support has been provided through of prism of the social investment market, based on the ultimate goal of enabling organisations to 'scale-up' and take on finance via the social investment market.

Missing pieces of the jigsaw

As one serial social entrepreneur told the Commission [28]: "Providing finance does not make a business fly. In fact, it is the other way about – if you get your business into good shape then it's easy to get finance. Investment is just one, and perhaps not a very important, piece of the jigsaw."

"Social Enterprises need support in a wide range of areas, including governance, financial management, HR, comms, market research and more. Now even wider support programmes, like ICRF, always seem to be conditional on securing investment."

Significant support not linked to investment support remains in place for social enterprises and social entrepreneurs at the start up stage from organisations including Unltd and School for Social Entrepreneurs. However, there is little help aimed at established, particularly local, small to medium social enterprises.

One problem with an entirely social-investment focused approach to social enterprise support is that start-up organisations may be pushed towards social investment before they need it.

A potentially bigger problem is that many new or existing social enterprises that aim to meet social need sustainably in a particular local area, rather than aiming to scale-up, are not in a position to access any specialist support at all.

Conclusions

Since 2010, growing support for the development of the social investment market has coincided with a significant reduction in support for social enterprise in a general sense.

Points to consider:

> Whether the delivery of social enterprise business support as part of programmes designed to enable social enterprises to access social investment is always the best way to deliver effective and appropriate support
> Whether the allocation of both financial and staff resources in central government between support for social investment and support for social enterprise more widely, reflects the balance of support needs
> Whether and how groups of people in communities who want to create businesses to meet local need rather that scaling up are effectively supported to do

[25] https://www.biglotteryfund.org.uk/global-content/press-releases/uk-wide/big-paves-way-forward-through-social-investment

[26] https://www.biglotteryfund.org.uk/global-content/programmes/england/next-steps

[27] https://www.biglotteryfund.org.uk/sioutcomesfunds

[28] Email correspondence

The market since BSC's launch. Part 3 – Give us a break
Initial the policy rhetoric from BSC appeared to reject that idea that the social investment market could be adapted to meet the needs of Social Sector Organisations.

Talking in 2011, when his organisation was in the process of being created, BSC chief executive, Nick O'Donohoe, told Third Sector [29] that: "We're not interested in grants or soft loans," before adding: "We are an investment institution."Since then, while the policy may not have changed – BSC itself does not provide soft loans or grants – the rhetoric around subsidy has changed substantially.

[29] http://www.thirdsector.co.uk/interview-nick-odonohoe/finance/article/1090205

Then in August 2013, reflecting on the 'Lessons Learned from Establishing the World's First Social Investment Bank' in an article for the Impact Investing Policy Collaborative [30], O'Donohoe is clear that: "Most social investment requires subsidy, and subsidy should not be a dirty word. The enterprises we invest in typically lack scale, carry levels of risk that are disproportionate to the financial return, provide goods or services in markets or to clients where the margins are too thin, rarely provide any visibility on exits and often have capped returns to shareholders."

[30] http://iipcollaborative.org/lessons-learned-from-establishing-the-worlds-first-social-investment-bank/

He adds that (our emphasis): "All of these factors mean that developing and growing a robust social investment market will *almost always* mean finding ways of combining grants and investment capital or introducing other subsidies. This could for example be through tax relief or partnership with grant making organisations such as the Big Lottery Fund."

The subsidy suggested here goes beyond the indirect subsidies provided through investment readiness programmes to include direct subsidies for investments, either through tax breaks or grant-funding.

As discussed in Section 3, Social Investment Tax Relief (SITR), announced in the budget in April 2014 [31], gives: "individuals who invest in qualifying social organisations a reduction of 30% of that investment in their income tax bill for that year." SITR serves primarily to level the playing field between private sector businesses and Social Sector Organisations. Similar tax reliefs have long been available to support investments in Companies Limited by Share but those Social Sector Organisations who do not issue share capital (the majority) have not been able to take advantage of them.

[31] https://www.gov.uk/government/publications/social-investment-tax-relief-factsheet

But as a tax break for individuals, SITR does not do anything to make BSC's funds more relevant to Social Sector Organisations who require relatively small amounts of cheap, risky, long-term finance. But it does make it more likely that individuals will provide that finance.

The market since BSC's launch. Part 4 – Subsidised funds
The social investment market described in GHK's Growing the Social Investment Market included a majority of SIFIs who were not sustainable themselves. This is not necessarily because these organisations were failing; some SIFIs deliver subsidised activities to address market failure and receive grant or contract funding – often from the state – to allow them to:

> Offer grants alongside loans as part of a 'mixed-funding' or 'blended capital' approach
> Provide investees with business advice and support
> Subsidise the costs of making investments

While there are no figures currently available that are directly comparable to the GHK data from 2011/12, many of the SIFIs operating with subsidised business models are Community Development Finance Institutions (CDFIs) and the role of CDFIs is discussed in Section 4.

While subsidised funds do not necessarily provide finance that social sector organisations regard as 'cheap', they often make relatively small, unsecured investments.

SIFIs making small unsecured investments have continued to exist, and in some cases expanded their activities, since BSC's launch but have not generally been in a position to take on BSC's funds based on their business models.

Marketing disruption
Some subsidised SIFIs have received funding through the Cabinet Office-funded, Social Incubator Fund.[32] This £10 million fund, launched in July 2012 and administered by The Big Lottery Fund, has funded 10 'social incubators' focused on different themes or in particular geographical areas. These incubators use a range of different models to invest in early stage 'social ventures'.[33] Although incubators make repayable investments, they are not necessarily expected to become commercially sustainable through returns on these investments.

The Social Incubator Fund is a time-limited government-funded programme and is not intended to be sustainable. The Fund reflects the government's policy of 'supporting the development of a strong pipeline of viable social investment opportunities'.[34] It's practical relationship to the rest of that pipeline – investment readiness support and, ultimately BSC-backed funds – is unclear.

[32] https://www.biglotteryfund.org.uk/socialincubatorfund

[33] Some incubators support 'for-profit' social ventures which would not necessarily meet the definition of a Social Sector Organisation

[34] https://www.gov.uk/government/publications/growing-the-social-investment-market-a-vision-and-strategy

Back to the Futurebuilders?
The last year has seen significant developments in the market for 'blended capital', with Big Lottery Fund allocating significant resources to two new organisations. The term blended capital refers to mixture of grants and loans.

As suggested by, Nick O'Donohoe's comments on subsidy, BSC has sought to increase the relevance of its activities to social sector organisations by working with Big Lottery to create 'Access - The Foundation for Social Investment'. This will provide both investment readiness support and a £100 million 'blended capital' fund. SIFIs will be able to bid for Access funds on a similar wholesale basis to that used by BSC. It seems likely that Access will attempt to provide some 'cheap, risky, long term growth finance to social sector organisations'.

It seems likely that Access will attempt to provide least some cheap, risky, long term growth finance to social sector organisations however it is not clear exactly how the organisation fits with the aim of creating a sustainable social investment market.

The other 'blended capital' scheme launching in spring 2015 is Power to Change [35], an 'an independent charitable trust endowed with £150 million from the Big Lottery Fund to support *community businesses* across England'.

[35] http://www.thepowertochange.org.uk/

It is predicted the majority of Power to Change funding will be grants however the new trust is planning to allocate a significant portion to subsidising social investment deals. The exact model used for this subsidy has not yet been disclosed.

It seems that the creation of these two new institutions may be part of a response to the limitations of the current social investment. This return to models of blended capital which had been left behind for the last five years suggests that the authors of this report and our Commissioners are not alone in recognising certain problems in the market, although they have yet to be admitted explicitly by policymakers.

Conclusion

The short answer to whether social investment, as currently conceived, is meeting or has the potential to meet some of the demands of social sector organisations is "no".

This is not to say that none of the activity currently described as 'social investment' in the UK has the potential to meet the demands of social sector organisations. The problem is that the current model for a 'social investment market' being promoted by the UK government and BSC is not succeeding in significantly increasing the numbers of social sector organisations who are accessing finance or the relevance of the products available to them.

Where there is evidence of unmet demand for repayable finance from social sector organisations, that demand is either from 'bankable' organisations who want money at a cheaper rate of interest than is available from mainstream lenders, or relatively small organisations wanting 'cheap, risky, long-term growth finance in the tens – but not hundreds – of thousands'.

BSC's initial model of seeking to use the majority of its capital to 'crowd in' institutional investment has not led to the creation of large scale funds targeted at meeting that kind of demand.

BSC's work since-2012 has driven the emergence of a small market of SIFI-administered funds aiming to invest large amounts of money in (mostly) large social sector organisations with high growth potential, supported by a government-funded investment readiness programme (ICRF). This may be a positive development in itself but it does match up to the rhetoric about social investment from politicians and social investment leaders.

There is no evidence that the creation of 'the social investment market' in the UK has made any difference whatsoever to the ability of an average-sized social enterprise (turnover £187,000) to access an affordable £40,000 unsecured loan.

The initial BSC model was not an evidence-based response to need: it was a leap of faith based on the notion that that there is a commercially sustainable space where market failure overlaps with the possibility of a viable business models.

Significant amounts of public money and Big Lottery have been spent on supporting the attempt to test this model. Now significantly more is being spent to meet some of the need which that model has been unable to meet.

Key lessons that could be learned from during this period include:

> There is an in-built conflict between creating a market that 'sustainable' but also offers access to 'affordable finance' for social sector organisations who cannot get it elsewhere.
> An increase in demand for large social investments to support public service delivery has not yet materialised and seems unlikely to do so at the levels initially expected
> While some social sector organisations are keen to receive 'investment readiness' support, it is unclear the extent to which organisations who become investment ready are seeking 'social investment' rather than mainstream finance
> It is generally unclear to what extent the social investment market is able to compete with mainstream providers when offering finance to 'bankable' organisations
> Social investment leaders now believe that that 'most social investment' requires subsidy the rationale for, or exact role of subsidy within the market is not always clear
> The percentage of Big Society Capital funds going to frontline social sector is relatively small (20%) with the rest currently supporting wider market development activities
> Many organisations within the social investment market that seek to meet evidence-based demand from social sector organisations are currently ineligible for investment from Big Society Capital because their business models are not regard as being 'sustainable'
> The idea of a commercially 'sustainable' social investment market remains an idea while in practice, there are very significant subsides being spent in order to sustain the market.

What happens next?

BSC's three-year strategy, published in May 2014 [36], outlined four key elements of their vision (BSC's bolding):

> Improving access to finance for **small and medium sized charities** and social enterprises
> Helping the most **innovative** approaches to tackling social problems grow and replicate
> Building **mass participation** in social investment
> Bringing far greater **scale** in the financing of social issues

These aims seem to recognise some of the criticisms of social investment and BSC to date. But the mismatch between the most heavily supported forms of supply and the research-backed demand are so great that there is need for more fundamental consideration of whether 'the social investment market' is a useful idea at all.

Many social sector organisations will welcome the fact that significant resources are being spent on attempts to tackle this mismatch through subsidised 'blended capital' funds designed to widen access to the social investment market. On the other hand, there are many current 'social investment' activities – unsecured loans from 'angels', community share offers, soft-loans and quasi-equity investments from trusts and foundations, loans from friends and family, loans from large SSOs to smaller ones – that both help to meet unmet demand from significant numbers of social sector organisations and take a distinctly social approach to investing in the process. Currently, however, most of these activities exist at the margins of 'the social investment market' rather than the heart of it. They also appear to offer something truly social in practice and not just in motivation, through more flexible and softer terms – perhaps because the investor is itself a social sector organisation, perhaps they use less intermediated models that reconnect a social bond between investee and investor, and they allow for the more subjective preferences of individual investors to come through, etc.

If we are going to create a social investment market primarily focused on meeting unmet demand from social sector organisations and/or based on broader, fundamentally social approach to investing we need to support the most promising models of truly social investment and the development new ones. We also need to be clear about what we think the social investment market is for beyond sustaining its own existence and that of its most significant players.

[36] http://bigsocietycapital.com/blog/our-strategy-next-three-years

5 Principles of social investment

72 There are two separate aims which could also represent sensible policy goals for any future UK government:

1. Better access to finance for social sector organisations; and
2. Investment to flow in a more socially impactful way.

But these are not one and the same thing. With regard to the first, social sector organisations can access finance from a range of providers with different motivations. And for the second, investors can create greater social impact without necessarily investing in the social sector.

And crucially in this context, neither of these are the same thing as "social investment". So what is social investment? Can it be defined?

Here we can learn from the debate around the idea of "social enterprise". Social enterprises do not have a unique claim on making the world a better place. And businesses of all types can create social value, as can the public sector. But while social enterprise is not always the answer, we do have a popular concept of "social enterprise" which has some defining principles.

We have this concept of social enterprise because some people believe in it as an idea. Not everyone – many people can and do seek to make the world a better place through private business models or through public institutions. But some people happen to believe in something called "social enterprise".

So if we are to have something called "social investment" – beyond the issue of access to finance for the social sector and beyond the idea that capital should flow more in a more socially impactful way – then it must stand for something. It must be based on some principles which define it. What might these defining principles be?

We have yet to come across any defining principles for social investment. This perhaps partly explains frustrations in some parts with the practice of social investment. So here, and perhaps for the first time, we propose some principles which could define social investment. They are inspired, in part, by various (although often broadly consistent) definitions of social enterprise. We propose that social investment should have the following characteristics:

> pursues an accountable social or (environmental) purpose;
> is autonomous of the state;
> has the (mission of the) investee as the principle beneficiary of any investment;
> is transparent about measuring and reporting the social value it seeks to create; and
> is structured to create financial value or organisational capacity over time, for example, by help ing the investee invest in growth, acquire an asset, strengthen management, generate income and/or make savings.

If "social investment" is to mean anything, then it needs to mean something!

Ideas for new social investment models

The following are intended as provocative ideas for genuine social investment models which could offer alternatives to conventional models and help meet unmet demand for affordable finance from VCSE organisations:

1. Digital platforms – taking inspiration from the likes of Wonga and crowdfunding platforms but specifically providing affordable finance for social enterprise. Digital lending and other finance platforms are already challenging conventional institutional finance models, retail banking and venture capital. They allow disintermediation – cutting out the middle man – which can take costs out of the system by introducing investors more directly to investees, keeping the cost of capital down.

2. Behavioural insights – taking inspiration from the Grameen model where peers take collective responsibility for debts which helps keep defaults low. Or similarly, taking inspiration from community-owned shops' astonishingly low failure rate as a result of the incentives created when a shopper is also an owner. By harnessing the incentives at the heart of these models, due diligence costs can be reduced and defaults minimised, keeping the cost of capital down. The 'Honesty Box' example (page x) is a more detailed example of specific behavioural approach.

3. 'Co-mingling' - taking inspiration from rural communities where the Village CORE programme was funded by Esmée Fairbairn Foundation, Co-operative and Community Finance and villagers, providing a mix of grants, debt and equity for community-owned village shops.[1] Government, grant-makers, foundations, philanthropists, individuals and communities can provide softer, cheaper finance alongside more financially motivated investors. While this raises questions of whether it is right for government and others to subsidise investors in this way, the model has been proven to provide more affordable finance.

4. Cutting unnecessary costs – taking inspiration from investors and intermediaries who are established outside London, such as Key Fund in Yorkshire. Crowdfunder in Cornwall demonstrates a model where, by being located in Newquay, a popular holiday resort and surfing centre, it is still able to attract young, educated, enthusiastic professionals who might otherwise be attracted to working in London. But a number of costs for the business are lower than they might be located in the capital. Other models for inspiration include Resonance, Triodos, Unity Bank and Charity Bank, all located outside the M25.

5. A more rounded Venture Capital model – taking inspiration from Baxendale and MITIE investment models which share some similarities with VC models but aim for fewer 'failures' and more modest return from a higher percentage of winners. VC returns have averaged around zero since the dotcom crash and VC invested companies suffer from a high failure rate so adopting the VC model wholesale is in any case questionable. In financial terms, the Baxendale and MITIE perform well when compared to return in the wide VC market. Both models are also built around behavioural insights – that owner-employees can create incentives which are more likely to lead to business success.

[1] http://www.wikipreneurship.eu/index.php/Village_CORE

6. Social sector investors only – taking inspiration from the fact that non-property assets under management by financial services companies on behalf of civil society actually fell in value last year.[2] Some trusts and foundations should therefore be willing to consider a better alternative for at least some of their portfolio of flat or modest returns, and should therefore be able to provide cheaper capital than pensions funds or investment banks, for example. There seems to be little logic in trying to attract more mainstream institutional capital to invest in the social sector when social sector organisations already have billions of pounds of assets under management which are currently not delivering positive returns.

7. A peer-to-peer model – which takes inspiration from models such as Zopa and Funding Circle. Through social enterprises investing directly in other social enterprises and by cutting out the middleman costs can be reduced. Health and social care spin-out social enterprises have undertaken research into this model and, for example, Albion Care Alliance has subsequently invested in Active Minds. Other models could include large asset-rich social sector organisations buying property for smaller VCSEs to inhabit and buy over time, effectively creating social sector shared ownership mortgages which could be cheaper than conventional mortgages.

8. Gamble on the gap in perceptions of risk – taking inspiration from CAF Venturesome, Charity Bank, Futurebuilders and emerging data on the relative robustness of social sector organisations. Charities and social enterprises have often been perceived to be risky investment propositions yet each of these funds has proved more viable than originally expected. Evidence suggest that social enterprises may be more resilient than other SMEs and at least more resilient than they have been perceived to be. Bridges Ventures first fund investing in underserved areas outperformed the majority of the VC industry and delivered what Bridges described as a "highly attractive return"[3] for investors, suggesting that the returns sought could have been lower and the fund still viable.

9. A 'Loser Model' – taking inspiration from philanthropy and recognising the reality that some investors would be willing to lose some of their capital for the right cause. Many people would be willing to provide small amounts of capital on the basis that it may not deliver financial return. While conventional financial structures fail to envisage this possibility and seek positive financial returns, new models could allow for negative returns. Investment could take the form of quasi-equity, using Revenue Participation or Annual Turnover Levies, for example.

10. Alternative Due Diligence models – taking inspiration from Big issue Invest and others work with developing alternative credit ratings with housing association tenants. New models of cheaper Due Diligence may be possible in certain sectors for example, if charity trustees with a track record with a number of charities are willing to borrow, the charity has an established history, assets and leverage ratios are low, then due diligence may be kept to a minimum compare to conventional models.

[2] NCVO

[3] http://bridgesventures.com/wp-content/uploads/2013/01/Bridges_10_Year_Report_final.pdf

11. Data and sector support enabled deal sourcing – taking inspiration from the likes of the SE100, Big Venture Challenge, Deloitte Pioneers programme and more, it is possible to identify a few well managed, successful, promising social enterprises who have already been through some kind of due diligence in order to gain access to these programmes. In a relatively small sector of the economy with a number of bespoke support programmes and using publicly available data on turnover and profitability, a few dozen relatively safe bets could be identified in a matter of hours and so offered more affordable finance.

12. Crowd matching – taking inspiration from the success of community shops and pubs and Resonance's Community Shares underwriting fund. Partnerships with the likes of Crowdfunder, BuzzBnk, JustGiving and others can provide reassurance to investors that the enterprise is widely supported by a community of interest, thereby reducing risk.

13. 'Piketty rate' Social Investment Tax Relief model – taking inspiration from the idea that investees and their missions should be the principle beneficiaries of any investment and not investors. SITR can enable finance to be provided at up to -30% IRR while investors can still break even.

14. "One in, one out" or "Cube" models – taking inspiration from the community shares experience whereby investors do not necessarily expect financial returns but may seek to redeem their investments at some point in the future when they 'leave the village' and the investee needs to find a replacement investor to find the money. A model could be established whereby a large number of investors with a link to the enterprise (e.g. patients, customers, staff, community) lend relatively small amounts of money to VCSE organisations but with no repayment schedule. (This is a sort of square-sided pyramid scheme!)

15. Access cheap money – taking inspiration from how the Funding for Lending[4] programme makes capital available at a price as low as 0.25% and how the Seed Enterprise Investment Scheme (SEIS) provides tax relief at 50% of the cost of the shares. Finding ways to access these schemes and in turn, make the capital available to social enterprises should allow finance to be provided on a more affordable basis.

16. Refinancing social sector debt – taking inspiration from NCVO figures which put civil society borrowing at more than £3 billion pounds, much of which is provided by commercial high street lenders. Some of this debt could be refinanced by social investors, offering marginally cheaper terms but still viable as an investment model as the borrower has already been through commercial lenders due diligence, will have a track record of lending and can often provide security.

17. Alternative Social Impact Bonds – taking inspiration from the Scotland YMCA experience, models of 'alliance contracting' and the ideas for a 'Social Finance Initiative'. Investors from the local community could invest relatively small amounts of money in these schemes, with returns capped which makes them less expensive in the long-term to the public purse and thus more attractive and replicable. Money actually flows to social sector delivery partners in the form of revenue, funding or income for services delivered, not as repayable finance, which is preferable to many organisations.

[4] http://www.bankofengland.co.uk/markets/Pages/FLS/default.aspx

The Honesty Box
Moving Impact Investing from Transaction to Trust

Overview
As the field of impact investment grows it faces a set of challenges previously unseen in the fields of commercial investment and social change:

> How do investors realise financial return while ensuring their investments do good?
> How do organisations committed to realising social and environmental change deliver without compromising their impact by returning much needed finance to investors?
> How can the relatively small sums required by social ventures bear the transaction costs of due diligence, negotiation and capacity building needed to satisfy investor requirements?

These three headline questions are increasingly being answered by the providers of capital taking a more finance first, transactional, approach to investing than is optimum for the delivery of the social ventures' mission. This is leading to larger deals with higher expected returns. In this way both smaller ventures are being denied access to much needed capital and social impact in organisations that do receive investment is often being compromised.

Is there another way? A way that optimises social impact and financial return – that moves people from thinking what can I get to asking what can I give? An approach that reduces transaction cost and opens the way for smaller investments to be viable? A way that shifts the locus of control from investor to venture? We think there is. We think it is about moving from a culture of transaction to a culture of trust.

The Challenge
The Neuroscience of Motivation
The parts of the brain that guide investing and doing good are not connected. In fact evidence suggests that they may be uncomfortable bedfellows at best and completely incompatible at worst. Activity in the posterior superior temporal cortex (pSTC) is triggered by intrinsic motivation (think doing good).[1] This is overridden by the part of the brain called the nucleus accumbuns, the area activated by extrinsic motivation (think making a return).[2]

Why does this matter? Because of the ways in which intrinsic and extrinsic motivations interact. Introducing the promise of monetary reward can actually reduce the motivation to do good. Extrinsic motivation trumps intrinsic. Monetary reward wins out over altruism. This may be why finance first approaches are coming to the fore over impact first in the field of impact investing. In short: the evidence suggests that our attempts to combine social impact and financial return, while intellectually appealing, are impeded by physiological and psychological factors that are incredibly difficult to overcome. This neuroscience based explanation is congruent with the reality that in social investment it is the investor who defines the parameters of engagement, thus ensuring social impact is debated within a financial context. But what if we could subordinate activity in the nucleus accumbuns to that in the pSTC and so place finance squarely at the service of impact?

[1] Dharol Tankersley, C Jill Stowe & Scott A Huettel. 2007. Altruism is associated with an increased neural response to agency. Nature.

[2] Knutson et al. 2001. Anticipation of Reward Recruits Nucleus Accumbens. Journal of Neuroscience.

Give and Take

Studies have shown that when people are motivated by generosity the financial performance of the interaction they are engaged can increase. In a famous study professor Leif Nelson from University of California's Haas Business School trebled the income from ticket sales at a museum by allowing people to pay what they wanted for entry, not for themselves but for the next visitor.[3]

In a 2000 study in Israel, researchers offered subjects the opportunity to earn money for a charity at varying levels of financial reward for responding to a simple time reaction game. Across the board, when subjects were offered small rewards (around 1.5 pence), they answered incorrectly more often than when they were offered no rewards at all. Some subjects did perform slightly better in response to larger rewards, but not in proportion to the increase.[4] So why is it that impact investing, while trying to do good in the world, is utilising a mechanism that apparently neither optimises social or financial return?

The Hypotheses

A working hypothesis is that by passing responsibility for setting financial performance metrics to the venture extrinsic motivations will be placed in a subsidiary position to the ventures objectives to do good in the world. In this way the transactional, financed focus, culture at the centre of impact investing would be replaced by a culture borne out of realising intrinsic motivation through developing a relationship of trust.

Secondary hypotheses in this project are that:

> In doing this, through developing this relationship of trust, investors will become more intrinsically motivated and be able to align their intrinsic and extrinsic motivations better;
> By inverting the locus of control, deal transaction costs will reduce thereby allowing both investor and venture to acknowledge lower rates of financial return; and
> Through the creation of a relationship of trust both parties will be able to price the deal on the basis of success rather than on the basis of failure, which will further drive down return expectations and open up the flow of capital to smaller and higher social impact projects.

The Experiment

To test these hypotheses social investors could commit to deals using the following methodology:

1. Develop a relationship of deep trust with the leader and senior management of a social venture needing investment;
2. Subordinate all traditional due diligence requirements to this relationship and place the responsibility for all negotiations and due diligence within the bounds of this relationship onto the venture;
3. Use this relationship to decide if the lead person/people have the integrity, aptitude and capabilities to succeed and honour your investment;
4. Commit to funding the venture and pass all decision making about financial returns, timescale for returns, whether debt or equity investment, etc. to the venture; and then
5. Be present as a trusted friend of the venture and available to them whenever they ask and for the duration of the investment.

If the hypotheses are correct then this approach could set the standard for how to utilise trust to invest for impact and solve, at least for some investors.

Ben Metz

[3] http://newscenter.berkeley.edu/2013/11/26/pay-it-forward/ and http://selfawarenessforchange.wordpress.com/2012/06/07/challenging-the-selfishness-paradigm/

[4] U. Gneezy & A. Rustichini. 2000. Pay enough or don't pay at all. The Quarterly Journal of Economics.

Section Conclusions and Recommendations

6 What can we do to make social investment better?

80 The Alternative Commission on Social Investment was set up investigate what's wrong with the UK social investment market and to make practical suggestions for how the market can be made more accessible and relevant to a wider range of charities, social enterprises and citizens working to bring about positive social change.

One of the key aims of the Commission has been to avoid making only wide-ranging recommendations that are easy to agree with but hard for individual stakeholders to act on.

For that reason, this section features a total of 50 recommendations, which do include broad, strategic points which we maintain are important but also more specific suggestions aimed at particular organisations.

Of these, we have identified 10 key suggestions – 2 focused on each of 5 key areas for action. These key areas are:

Transparency

The most commonly recurring theme when talking to Social Sector Organisations considering social investment is the mind-boggling nature of the market.

On a purely practical basis, if an organisations seeking finance wants £50,000 of investment and wants to know which SIFI might offer it, there's nowhere to go to find out. Most SIFIs don't tell the world who they invested in or on what terms. Beyond these practicalities, SIFIs and others in the market could be more transparent about what's so 'social' about their approach to social investment.

Transparency is important partly because organisations receiving public and charitable funds – as many SIFIs do – will increasingly lose credibility if they fail to live up to the standards they demand from frontline social sector organisations, particularly with regard to explaining what they're seeking to achieve and demonstrating it.

Even more importantly, though, it is in SIFIs' commercial interests to increase understanding and awareness of what they do amongst organisations that could benefit from investments – so more of them seek investment - whilst reducing the amount of time and resources wasted by social sector organisations seeking investment from SIFIs whose products are not relevant to their needs.

Greater transparency is a route to more deals being done and, by reducing process costs, better deals being done.

Wholesale changes
As the recipient of at least £400 million worth of unclaimed assets, along with £200 million from the Merlin banks, Big Society Capital (BSC) is the biggest single player in the development of the social investment market. It is unsurprising that BSC is criticised from many different angles by organisations and interest groups with a wide range of different agendas.

In most cases, Social Sector Organisations have limited understanding of, or interest in BSC's strategic role and only sometimes notice that very little of the unclaimed assets money is currently available in a form that relevant to their organisations.

Yet many SIFIs are also frustrated with BSC; that it is not able to offer them finance at a rate that would make it easier for them to offer more attractive deals to frontline organisations. Sometimes they are angry at the high process costs involved in dealing with BSC.

The biggest underlying problem for BSC may be the conflict between its aim to foster the growth of a distinct 'social investment market' with its strategic aim to 'crowd in' as much institutional investment as possible into that market. How do you go about building something different whilst also making it part of business as usual?

BSC does not need to abandon this strategy but it does need to consider how it could transform itself to enable it to provide more support for funds and investment models that:

(a) institutional investors are not ready to back yet but may be interested in once they have a track record
(b) may not require institutional investment to become sustainable

BSC should reconsider its role(s), seeking appropriate permissions from the next government, members of its Board, the Merlin Banks and the European Commission - whichever are necessary – to enable it to support as much distinctively social investment as possible whilst also acknowledging and supporting investment which has a positive impact on the world beyond narrow 'the social investment market'.

Social investment is dead!

One key reason why social investment is so unpopular with many in the voluntary sector is the extraordinary level of hype deployed by government ministers and some social investment leaders during the post-2010 period.

Ministers from the Prime Minister down have implied (or, in some cases, openly stated) that social investment has been fostered by government in order to enable significant numbers of Social Sector Organisations to respond to a situation of reduced public spending. This inevitably creates distrust in a sector where many staff are ideologically or just practically opposed to spending cuts.

Meanwhile, the gap between hype (the "First Trillion" and so on) and reality (BSC investing a few million pounds in the social sector over an entire parliamentary term) has led to significant disappointment and growing cynicism amongst Social Sector Organisations.

Equally damaging is the impression – fuelled by talk of 'social investment as an asset class' - that some in government and the social investment sector want to create a social investment market for its own sake, which has little to do with Social Sector Organisations, or more importantly, their beneficiaries.

There remains a lack of clarity about what social investment is meant to be for. While 'access to finance for Social Sector Organisations' would make sense as a policy agenda from the point of view of social sector organisations and the socially positive use of finance in a general sense makes sense to those who want to see a less socially divisive capitalism, neither of these are the same thing as 'social investment'. The rationale for a distinctive 'social investment market' where these two agendas might overlap is not clear and has yet to be convincingly made by any advocates of the idea.

Long live social investment!

Given the confusion about what social investment is, stakeholders with an interest in social investment should work together to decide what, in principle, they are championing. Together, they should set out what it is that differentiates 'social investment' from other approaches to investment. These principles could help guide behaviours in the market.

The result will not be that all organisations in the UK get the social investment market that they want. But everyone will be clearer about what they can hope and expect social investment to offer, taking the sting out of some of the debates.

Beyond clarifying what they're for, SIFIs in particular could improve upon their current models, taking inspiration from distinctly social principles. Many Social Sector Organisations believe that SIFIs 'sit in their expensive London offices' offering finance that is of little relevance to the rest of the UK modelled on the venture capital industry. While some are already acting to tackle this perception, all SIFIs can so more to better engage with and understand demand across the UK, respond to it and live up to distinctly social principles. For example, most SIFIs could go further to recruit more people with social sector experience from across the UK, giving them greater capacity to understand the business models and world views of the organisations they exist to invest in.

SIFIs could also consider whether the due diligence models they use are practical and appropriate for size and type of deals they make and the organisations they invest in.

Doing it ourselves

The Commission believes that Social Sector Organisations can and should take some responsibility for helping to shape the kind of social investment market they want and need. That can include urging umbrella bodies to more accurately report on and explain their experiences of the current market – and also being more assertive about telling SIFIs and BSC what they want from the market.

Larger Social Sector Organisations also have a possible role to play as investors themselves. If they have significant cash, reserves and other assets, they could use that financial strength to themselves support the development of a more robust, confident and self-sufficient social economy and a more truly *social* investment market.

Recommendations

Key Points:

- **Transparency** – *Publish information on all social investments across all investors* – with investees anonymised if required (Big Society Capital, SIFIs, the Social Investment Forum)

- *Explain if and how social value is accounted for within your investments* – do you expect investees to demonstrate their impact as a condition of investment? Do you offer lower interest rates based on expected impact? Are you prepared to take bigger risks based on expected impact? (Big Society Capital, SIFIs)

- **Wholesale changes** – *Reconsider the role of Big Society Capital* – prioritise building a sustainable and distinctively social investment market over securing a sustainable existence for Big Society Capital – (Big Society Capital, Cabinet Office)

- *Consider splitting the investment of Unclaimed Assets and Merlin bank funds.* Unclaimed Assets, allocated by law to Social Sector Organisations, could be invested on terms that better meet demand than currently, while Merlin bank funds could be invested in a wider group of organisations, with a focus on positive social value – (Big Society Capital, Cabinet Office)

- **Social investment is dead!** – Minimise all forms of social investment hype that might inflate expectations and under no circumstances imply that social investment can fill gaps left by cuts in public spending (Cabinet Office, DWP, MoJ, HM Treasury, Big Society Capital, Big Lottery Fund, NCVO, ACEVO, Social Enterprise UK)

- *Avoid treating the development of the social investment market as an end itself* – social investment is a relatively small phenomenon overlapping with but not the same as 'access to finance for social sector organisations' and 'increasing flows of capital to socially useful investment'. These wider goals should be prioritised over a drive to grow the social investment market for its own sake – (Cabinet Office, Big Society Capital)

- **Long live social investment!** – Work together in equal partnership with the social sector to develop a set of principles for what makes an investment 'social' - (Policymakers, Big Society Capital, Key Stakeholders, SIFIs, Umbrella bodies, the Social Investment Forum, SSOs)

- *Social investors should better reflect and understand the market they are seeking to serve by getting out and about, meeting a broader range of organisations* – particularly organisations based outside London – recruiting from the sector and cutting costs that deliver no social value – (SIFIs)

- **Doing it Ourselves** – Create a 'Compare the market'/'trip advisor' tool for social investment – enabling organisations to rate their experiences and comment – (Umbrella bodies and SSOs)

- *Back yourselves and invest in each other* – Social sector organisations should consider cutting out the middleman and developing models where they can invest in each other, where legal and appropriate – (SSOs)

Full Recommendations

1. Transparency:

i. *Publish information on all social investments across all investors* – with investees anonymised if required (Big Society Capital, SIFIs, the Social Investment Forum)

ii. *Explain if and how social value is accounted for within your investments* – do you expect investees to demonstrate their impact as a condition of investment? Do you offer lower interest rates based on expected impact? Are you prepared to take bigger risks based on expected impact? (Big Society Capital, SIFIs)

iii. *Explain who Big Society Capital (BSC)-backed market is for* – Be clear about ***how*** many social sector organisations can realistically expect to receive investment from the BSC backed market (assuming it works). If it's 200, be honest about that (Politicians, Cabinet Office, Big Society Capital)

iv. *Explain what Big Society Capital (BSC)-backed market is for* – Be clear on policy positions on crowding in/crowding out – is the point of BSC to bring mainstream investors in or grow the social investment market to crowd them out? (Cabinet Office, Big Society Capital)

v. *Explain the relationship between Big Society Capital and the Merlin banks* – What is the banks role (if any) in governance and strategy? Under what circumstances would they receive dividends? (Cabinet Office, Big Society Capital)

vi. *Be clear about terminology* – what specifically do you mean by, for examples, 'social investment', 'impact investment', 'finance for charities and social enterprise' – and consistent across government departments (Cabinet Office, Big Society Capital, SIFIs, Big Lottery Fund, Umbrella Bodies)

vii. *Clarify how much is in dormant bank accounts* – look at other unclaimed assets, insurance, Oyster cards, Premium Bonds, and other products. (Cabinet Office, Big Society Capital)

viii. *Publish asset management strategies* – including details of how endowments are invested in a socially and environmentally responsible manner. (Big Society Capital, SIFIs)

ix. *Publish details of investments made on your website* – to enable Social Sector Organisations to understand that size and type of investments you make (SIFIs)

x. *Be transparent about costs* – be clear about what fees you charge and why (Big Society Capital, SIFIs)

xi. *Be clear about what is 'social' about you approach to investment* – what is it that you are doing that a mainstream finance provider would not do – and why is it useful? Mandatory statement of fact sheet. Report on overheads. (Big Society Capital, SIFIs)

2. Wholesale changes:

i. *Reconsider the role of Big Society Capital* – prioritise building a sustainable and distinctively social investment market over 'crowding in' institutional finance into a new market doing – (Big Society Capital, Cabinet Office)

ii. *Consider splitting the investment of Unclaimed Assets and Merlin bank funds.* Unclaimed Assets, allocated by law to Social Sector Organisations, could be invested on terms that better meet demand than currently, while Merlin bank funds could be invested in a wider group of organisations, with a focus on positive social value – (Big Society Capital, Cabinet Office)

iii. *Consider demarcating the unclaimed assets spending as 'social investment' and the Merlin funds as 'impact investment'* – (Cabinet Office, Big Society Capital)

iv. *Particularly consider investing some Merlin funds in CDFIs & credit unions* that provide finance for individuals and mainstream businesses in response to social need (Big Society Capital)

v. *Bear more transactions costs* – particularly those costs which are imposed on SIFIs through demands for extensive legal processes (Big Society Capital)

vi. In the event that it becomes profitable, *before paying out dividends to shareholders Big Social Capital should allocate 50% of profits into a pot of funding to reduce transaction costs* for SIFIs enabling them to reduce the cost of finance for SSOs (Big Society Capital)

vii. *Be more flexible in supporting SSOs to engage with public sector outsourcing and be supported by policymakers to do so* learning lessons from the experience of the MoJ Transforming Rehabilitation fund (Big Society Capital)

viii. *Consider democratising Big Society Capital board* – Or at least be more open and clear about who has controlling stakes and vetoes within its structure . Consider how to make both board and staff team more representative of the sectors that they serve (Big Society Capital, Cabinet Office)

ix. *Change the name 'Big Society Capital' to something less politically charged* – (Big Society Capital, Policymakers)

x. *Consider whether all remaining funds in dormant bank accounts need to be invested in Big Society Capital* or whether remaining funds could be used in other ways – for example, creating local or regional social investment funds controlled by local people (Cabinet Office)

xi. *More funders should consider their possible role in social investment wholesaling* including British Business Bank, Esmee Fairbairn, Unltd, Nesta, Wellcome Trust (Funders)

3. Social investment is dead!

i. *Minimise all forms of social investment hype* that might inflate expectations and under no circumstances imply that social investment can fill gaps left by cuts in public spending (Cabinet Office, DWP, MoJ, HMT ministers and officials, Big Society Capital, Big Lottery Fund, NCVO, ACEVO, Social Enterprise UK)

ii. *Avoid treating the development of the social investment market as an end itself* – social investment is a relatively small phenomenon overlapping with but not the same as 'access to finance for social sector organisations' and 'increasing flows of capital to socially useful investment'. These wider goals should be prioritised over a drive to grow the social investment market for its own sake– (Cabinet Office, Big Society Capital)

iii. *Consider the 'wider universe' of socially impactful investment* including additional research on the £3.7 billion investment in SSOs primarily from mainstream banks (Umbrella bodies, Researchers, Big Society Capital, Mainstream Banks)

iv. *Consider how SSOs can be better supported to access mainstream finance* through guarantees and other subsidies, and through information and awareness-raising (HM Treasury, Cabinet Office, Big Lottery Fund)

v. *Apply an added value test* before supporting funds and programmes designed to develop 'the social investment market', be clear about the likely social outcomes that social investment offers that could not be better delivered another way (Cabinet Office, Big Lottery Fund)

vi. *Promote greater focus on socially motivated investment in HMT, BoE, and FCA and BIS* – (Politicians, Cabinet Office)

vii. *Consider providing guarantees for social investment via crowdfunding platforms* based on clear position on what 'social investment' means in this context (Cabinet Office, Access)

viii. *Provide opportunities and support for citizens to invest in socially motivated pensions* (HM Treasury)

4. Long live social investment!

i. Work together in equal partnership with the social sector to *develop a set of principles for what makes an investment 'social'* – (Cabinet Office, Big Society Capital, Big Lottery Fund, SIFIs, Umbrella bodies, the Social Investment Forum, SSOs)

ii. *Social investors should better reflect and understand the market they are seeking to serve by getting out and about*, meeting a broader range of organisations – particularly organisations based outside London – recruiting from the sector and cutting costs that deliver no social value – (SIFIs)

iii. *Employ more social entrepreneurs and others with social sector experience* – take on more staff with direct, practical experience of using repayable finance to do social good and enable them to use that experience to inform investment decisions (Big Society Capital, SIFIs)

iv. *Focus on additionality* and filling the gaps esp small, patient risky, equity-like – (Big Society Capital, Key Stakeholders, SIFIs)

v. *Consider the risk of the social investment market failing to make a significant number of demonstrably social investments at all* alongside the risk of some of those investments being unsuccessful (Big Society Capital, SIFIs)

vi. *Don't replicate expensive models from mainstream finance,* do explore how to use social models and technology to keep costs down (Big Society Capital, SIFIs)

vii. *Explore alternative due diligence models* including developing common approaches to due diligence for different types of social investment – (Social Investment Forum, SIFIs, Big Society Capital)

viii. *Support the development of Alternative Social Impact Bonds* options include: (a) models which enable investors from the local community to invest relatively small amounts of money with lower expected returns making them less expensive in the long-term to the public purse, more attractive and replicable; (b) a waterfall approach that sees X% of performance above a certain level reinvested in the enterprise the community (Cabinet Office, Big Society Capital, SIFIs, SSOs)

ix. *Support the development of a distinctively social secondary market for social investments where early stage investors* will be able to sell on investments to investors with similar social commitment but less appetite for risk (Cabinet Office, Big Society Capital, Access)

x. *Consider the practicality of establishing a simple registration and regulation system for organisations eligible for social investment – as supported by unclaimed assets* – with unambiguous criteria for registration of organisations who consider themselves to be 'social' but not use a recognised social corporate structure – (Cabinet Office)

xi. *Listen to the people* – find out what (if anything) citizens in general think about social investment (Cabinet Office, Big Society Capital, SIFIs)

xii. *'Crowd in' people who aren't rich* – support models of social investment that enable investments from people with moderate incomes and assets, and remove barriers that prevent smaller investors from accessing tax breaks such as SITR (HMT, Cabinet Office, Big Society Capital, SIFIs)

5. Doing it ourselves:

i. *Create a 'Compare the market'/'trip advisor' tool for social investment* – enabling organisations to rate their experiences and comment – (Umbrella bodies and SSOs)

ii. *Back yourselves and invest in each other* – Social sector organisations should consider cutting out the middleman and developing models where they can invest in each other, where legal and appropriate – (SSOs)

iii. *Large asset-rich social sector organisations should consider supporting smaller organisations to take on property* either by buying it for them or helping them to secure it by providing a guarantee facility where legal and appropriate (SSOs)

iv. *Ignore hype about the social investment market* – (Umbrella bodies, SSOs)

v. *Go mainstream* – if looking for investment, consider banks and other investors and not just specifically social investment (SSOs)

vi. *Before seeking investment, work out whether you are looking for repayable investment or whether you are looking for a grant* – (SSOs)

vii. *Identify what is 'social' about the investment approach that you are hoping for from investors:* are you expecting cheaper money, higher risk appetite, more flexibility, more 'patient' capital, wrap around business support? (SSOs)

viii. *Understand that just being socially owned may not be enough* – you don't have to care about impact frameworks but need to recognise that an investor will want to know how you are managing your success at what you claim to do (SSOs)

The work of The Alternative Commission on Social Investment was funded by The Esmèe Fairbairn Foundation.

Section

7 Appendix

The Alternative Commission on Social Investment compiled this report based on:

> 2 meetings between the Commission Team and our 14 Commissioners – in October 2014 (8 Commissioners attended) and January 2015 (13 Commissioners attended)
> 4 individual meetings between Commission Team members and individual Commissioners who were not able to attend the initial meeting
> Desk-based research
> 26 interviews with people involved in the UK social investment market and others with insights to offer on its development
> 9 roundtable events – either focused on specific countries or regions of the UK or addressing particular topics – with 76 additional attendees
> An online survey with 21 responses
> 4 discussions with key stakeholders in the social investment market to get initial feedback on the Commission's draft recommendations
> Other input from other interested parties via email or at events

Interviewees – September 2014-March 2015:
Geetha Rabindrakumar *(Big Society Capital)*; Nick O'Donohoe *(Big Society Capital)*; Jess Daggers *(Social Impact Consultant)*; Bertrand Beghin *(Numbers 4 Good)*; Andrew O'Brien *(NCVO)*; Rohan Martyres and Andrew Croft *(CAN)*; Arvinda Gohil *(Emmaus)*; Michael Wright *(Guys & St Thomas Charity)*; James Meekings *(Funding Circle)*; Aine Kelly *(Big Society Capital)*; Jeremy Rogers *(Big Society Capital)*; Peter Holbrook, Chief Executive *(Social Enterprise UK)*; Vinay Nair *(Social Investment Business/Social and Sustainable Capital)*; Matt Robinson *(Big Society Capital)*; Katie Hill *(Access: the foundation for social investment)*; Alex Watson *(Ben & Jerry's)*; Seva Phillips *(Young Foundation)*; Alistair Grimes *(Rocket Science)*; Thom Kenrick *(RBS);* Mike Mompi *(Clearly So)*; Chi Onwurah MP *(Shadow Cabinet Office Minister)*; Tom Fox *(Unltd)*; Karl Harder *(Abundance)*; Theodora Hadjimichael *(CDFA)*; Rob Parker *(Cabinet Office)*.

Discussions of recommendations with Key Stakeholders – January 2015-February 2015:
Big Lottery Fund – Dawn Austwick and Matt Smith
Social Investment Business – Jonathan Jenkins
Cabinet Office – Kieron Boyle
Big Society Capital – Geetha Rabindrakumar and Matt Robinson

Attendees at Roundtable Events:

Sheffield mini-roundtable: Morgan Killick *(Voluntary Action Sheffield)*, Kiri Langmead *(Sheffield Hallam University)*, Jane Leathley *(Voluntary Sector Consultant)* – David Floyd from The Alternative Commission

North East – Newcastle: Peter Gilson *(Northstar Ventures)*, Julie Wake *(Keyfund)*, Debbie Lamb *(Locality)*, Stephen Bell *(Changing Lives)*, Andrew Gooding *(Lynemouth Development Trust)*, Kate Welch *(Social Enterprise Acumen)*, Karen Wood *(North East Social Enterprise Partnership)*, Amjid Khazir *(Media Cultured)*, Simon Hanson *(FSB)* – David Floyd and Mike Harvey *(Candour Collaborations / Commissioner)* from The Alternative Commission. Special thanks to Simon Hanson for organising the event and Northstar Ventures for hosting.

NCVO – London: Arvinda Gohil *(Emmaus)*, Sandy Hore-Ruthven *(Creative Youth Network)*, Hilary Farnworth + Colleague *(Ransackers Association)*, Representative from Waltham Forest Asian Seniors Club, Simon Rowell *(Big Society Capital)*, Nick Wilson-Young *(LB Camden)*, Andrew O'Brien *(NCVO)* – David Floyd and Nikki Wilson from The Alternative Commission. Special thanks to Andrew O'Brien for organising the event.

Scotland – Edinburgh: Pauline Hinchion *(SCRT)*, Malcolm Hayday *(SCRT)*, Thom Kendrick *(RBS)*, Alex Walker *(Ekopia)*, David Cousland *(Big issue Invest Scotland)*, Derek Marshall *(Factory Skatepark)*, Alistair Davis *(Social Investment Scotland)*, Aidan Pia *(Senscot)* – David Floyd from The Alternative Commission. Special thanks to Aidan Pia and colleagues at Senscot for organising the event.

Belfast – N. Ireland: Una McKernan *(NICVA)*, Nora Smith *(CO^3)*, Charlie Fisher *(DTNI)*, Fiona Molloy *(DTNI)*, Patrick Minne *(Charity Bank)*, Paul Donaldson *(Charity Bank)*, Sharon Polson *(Invest NI)*, John Waddell *(DARD)*, Andrew McCracken *(CFNI)*, Derek Browne *(Southern Social Enterprise Hub)*, Ciara Rea *(Ashton Centre)*, Cecilia Whitehorn *(CM Works)*, Bob Harper *(NICVA)*, Murray Watt *(Supporting Communities NI)*, Seamus McAleavey *(NICVA)*, Michelle Wilson *(South Belfast Social Enterprise Hub)*, Orla O'Sullivan *(Building Change Trust)*, Robbie Best *(Building Change Trust)*, Michael Walker *(Orchardville Society)*, Nigel McKinney *(Building Change Trust)* – David Floyd and Niamh Goggin *(Small Change / Commissioner)* from The Alternative Commission. Special thanks to Nigel McKinney and colleagues at Building Change Trust for organising the event.

Midlands – Birmingham: Sipho Eric Dube *(Freelance - Arts and Spoken Word)*, Dr Simon Adderly *(University of Birmingham Business School)*, Lorna Prescott *(Dudley CVS)*, Charity Attendee *(anonymous for purposes of report)*, Imandeep Kaur *(Impact Hub Birmingham)* – Nikki Wilson from The Alternative Commission. Thanks to Impact Hub Birmingham for hosting the event.

E. of England – Ipswich: Ashley Cooke *(Ashca)*, Paul Henry *(Inspire2Enterprise)*, Adrian Scarratt *(Realise Futures)*, Sarah Sharlott *(Realise Futures)*, Marion Ransby *(NW Ipswich Big Local Trust)*, Nicky Stevenson *(Charity Bank / Social Enterprise East of England)* – Nikki Wilson from The Alternative Commission.

Richard Jenkins *(Association of Charitable Foundations)*, Jaishree Mistry *(Charity Bank)*, Ashley Horsey *(Commonweal Housing)*, Abigail Rotheroe *(New Philanthropy Capital)*, Michelle Benson *(School for Social Entrepreneurs)*, Alisa Helbitz *(Social Finance)*, Tim Wilson *(The City Bridge Trust)*, Chris McBride *(The Social Investment Business)*, Douglas Gunn *(Trust for London)*, Becky Green *(London Funders)*, David Warner *(London Funders)*, Holly Piper *(Venturesome / Commissioner)* – David Floyd and Nikki Wilson from The Alternative Commission. Special thanks to Becky Green and David Warner at London Funders for organising the event and Trust for London for hosting.

Social Impact Measurement – London Emilie Goodall *(Bridges Ventures)*, Richard O'Brien *(CAF Venturesome)*, Natalie Pinon *(Social and Sustainable Capital)*, Marcus Hulme *(Big Society Capital)*, Stephen Miller *(Unltd)*, Jenny North *(Impetus PEF)*, Sarah Forster *(Big Issue Invest)*, Jess Daggers *(Social Impact Consultant)*, Alex Nicholls *(Skoll Centre / Commissioner)* – David Floyd and Dan Gregory from The Alternative Commission. Special thanks to Alex Nicholls for organising the event and CAF Venturesome for hosting.

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