Community Southwark

An Introduction to Social Investment

The words 'Social Investment' are increasingly heard. It's been referred to as a way of harnessing entrepreneurship, innovation and capital to tackle society's deepest problems and ensuring that finance helps build a healthy society, rather than endanger it (Report of the Social Investment Impact Forum – 2014).

It's growing in size at over 20% per year ('Social Investment Explained '– SEUK and Big Lottery 2014).

But what exactly does it mean?

What is Social Investment?

Social Investment is 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.

Big Society Capital defines social investment as '*the provision of finance to generate social and financial returns'.* For the '*financial return, generally the principle amount invested will need to be repaid with an element of interest on top.* For the *social return, outcomes intended by the project will need to be met.'*

Social investment is not a grant or a donation. It is a **loan** provided to enable an organisation to generate more income or be more effective. It provides capital to enable social sector organisations to develop new and/or existing activities that generate income. ***These activities generate a surplus which is used to repay investors.*** The surpluses are usually created through trading activities, or donations. It is therefore not an income source, but a financial tool or enabler.

As voluntary and community organisations grow and develop, they need to consider which funding and financing options will be most useful and ultimately most sustainable in the long term. Loans or investment income may be an option where a large sum of money is needed, to bridge gaps between receipt of grant payments, or to enable projects to move forward during the time taken to raise capital from more traditional fundraising methods.

Note: Social Investment is not the same as 'ethical' investment, (which means the investor excludes certain investments due to social or environmental criteria e.g. tobacco or arms companies). The social investor goes further by investing in organisations with a positive impact.

Is there a trade-off between social and financial returns?

Social investors will often accept lower financial returns to achieve greater social impact, although there have been examples of the financial return exceeding the social return.

Who are 'social investors'?

The social investors providing this money include specialist banks, individuals, and charitable trusts, as well as organisations and funds that have been specifically set up to make social investments. Each has different motivations but what all social investors have in common.

Why is social investment in demand?

There are three main reasons why social investment has become an important part of the landscape:

- **It reduces pressure on grants and donations**: there is less money available, and this has increased demand on the grants that are still available from government, donations or charitable trusts.
- **It can be used again** to support more charities and social enterprises and help ensure grants go to where they are needed most
- **It can attract money from new sources** – individuals and mainstream finance which can be used by more organisations as more VCSEs are trading.

Which is more appropriate – grant, social investment' or 'conventional' investment?

Social investment may not be right for your organisation. Not all VCSE organisations can or should be trading organisations – some can only be funded by grants or donations; in other cases, a voluntary organisation may hold a long-term aim of turning an activity into a sustainable trading enterprise but grant funding may still be a better way of supporting its current work. Similarly, not all trading organisations need to take on this sort of finance – some may never need it. It also doesn't mean that an organisation can only either go for social investment or grants: many organisations seek to combine the two.

There is no point looking for investment unless an organisation has a clear idea about how and when it will be paid back. The most obvious advantage of grant funding is that it doesn't have to be paid back. However, should an organisation begin to trade in addition to receiving grant funding, any funder would also want to see that it was not making a loss.

The VCO should therefore consider:

- What is the money to be used for?
- How will this benefit the organisation
- Which source of funding is therefore most appropriate?
- Does the governing document give the power to borrow and potentially, to pledge assets as security?
- Does it have robust financial systems to manage a loan (or a grant) and the project?

Grant:

Situations where a grant may be useful and available to support your organisation's trading activities include:

- You need funding to test whether your idea works
- You need funding to find out whether anyone wants to pay for products and services.
- You need funding to sustain an activity that delivers great social value but doesn't bring in enough income/cannot bring in income.
- You need funding to help you reach the point where you can invest. You may need a mix of finance and grant.

Social investment:

Despite the obvious advantages of grants, there are also some reasons why taking on an investment alongside a grant or instead of one may be in the long-term interests of your organisation:

- **Speed:** Loans can be faster to arrange than grants. Grant makers often have prescribed timetables for applications – the loan application process is usually much quicker.

- **Less bureaucracy**: Loans often involve less reporting and monitoring, with instalment payments dependent on submission of regular reports.

- **Flexibility**: Investors are likely to be more flexible than grant funders about what you do. If you find your business plan isn't working, an investor is likely to be patient - if you do need to change your business model to one that's more likely to succeed.

- **Active involvement and support**: Investors are more likely to want to get actively involved to support your organisation. This can be useful, especially for start-ups.
- Social investment tends to be less restricted to particular project and outcomes than conventional grant funding, giving your organisation freedom use it most effectively; it can also mean less distraction chasing grants.

- **Business discipline**: Social investment can also help organisations increase their effectiveness through requiring them to improve their financial and business processes, and to be very clear on their priorities and objective

- **You can't get the money from a bank**: High street banks are not experts in investing in voluntary organisations and may not be confident to invest because they don't understand your organisation or its market.

- **You may get a better deal**: Many social investors receive government or philanthropic subsidies which may mean they can offer your organisation a better deal than investors who need to cover all their costs.

'Conventional Investment':

Organisations with a social purpose are not obliged to look for social investment. They can borrow money from mainstream banks and take on investment from people that support and invest in all types of business. The potential advantages of 'conventional' investment are:

- **Less complicated relationships:** A high street bank may lend you some money if they think you can pay it back, an 'angel investor' may invest in your business if they like it or think they can make money, a government scheme to support start-up businesses may lend to you if they think your organisation might succeed.

- **Better deals:** Mainstream banks may have better deals or rates on some products because of their greater scale.

- **Quick and accessible:** Another benefit of scale: banks have branch networks and online applications which can speed up the process. It is important to note that most mainstream or conventional investors will not be interested in the social aspect of what you do, but only in the business side of your organisation.

Most investment currently received by charities and social enterprises in the UK is not social investment. NCVO's 2014 Civil Society Almanac reports that in 2011/12 the voluntary sector owed around £4 billion in loans. Most of this investment is mortgages, with charities and social enterprises taking secured loans to buy property.

What next?

Once you have decided which is most appropriate (you can take advice on this – see under 'Resources' section of this Fact sheet) and, if you decide to take a loan, you need to be '**Investment ready'**):

Different investors may have very different ideas about whether an organisation is ready to receive an investment. There isn't one single way of judging whether your organisation is investment - ready (other than whether or not someone ultimately offers you some money) but there are ways of working out what sort of investment you're ready for. You may be ready for some forms of start-up investment simply on the basis that you have a really good idea and a group of people who are enthusiastic about making it happen. On the other hand, if you're looking to take on £500,000 to enable your organisation to scale-up, the investors you're approaching are going to expect much more understanding about how your business works, and how you create social value and how they'll get their money back.

Are you ready?

The information that investors may want to know about your organisation might include:

The people in your organisation:

- The skill and experience of your most senior members of staff
- The role of your board and governance structure
- The skills of your board in key areas such as finance, marketing, business
- development, human resources and legal
- The balance of your board in terms of both skills and representation of the
- community and people who use your services
- The overall skills and experience of your staff team and volunteers
- The level of financial and business skills within the organisation

What you do and who your customers are:

- How clear you are about the products and services you offer
- How many customers you have and who they are
- How are you different from your competitors
- Whether the market for what you do is growing or shrinking, stable or volatile
- How profitable your products and services are or will be
- How well connected you are to local or national networks and partnerships

How you do things, how well you do them, and how you know:

- Whether you have a clear vision of the impact you're trying to achieve
- Whether you have the capacity, resources and skills to deliver
- Your track record of delivery
- How well you engage with your community and/or people who use your services
- How you manage performance and measure impact

- How you report on your achievements and impact

Most social investors will expect you to be able to both articulate your social impact, and explain how you measure it. Have you tried and tested your work, and measured the results? Do you know what works and what doesn't? What are the key factors and partnerships that deliver best results? This matters to social investors.

How you manage your finances:

- What systems you have in place for managing your finances and producing accounts
- Your knowledge of your financial procedures and systems
- The state of your cash flow – e.g. over the past 12 months
- Your predicted cash flow – e.g. over the next 12 months
- The extent and quality of your internal financial reporting

Investors at the start-up stage won't expect you to have all this information, but for larger investments you will need to be able to answer investors' questions on all of these areas.

Where can your organisation get support to be Investment – ready?

What's on offer: Grants to support you to develop the capacity of your organisation, to enable you to reach the point where you're ready to take on investment.

Amounts available: £25,000 – £75,000 (Big Potential) / £50,000 – £150,000 (ICRF)

They will expect you to spend the money paying for specialist support to help you improve your organisation. They will then hope that you will go on to seek investment of anywhere up to a maximum £500,000 (Big Potential) or £500,000 and over (ICRF).

If you want more general help on getting ready for investment and finding it, you could apply to a support programme, such as the School for Social Entrepreneurs' Investment Escalator' or UnLtd's Big Venture Challenge. These programmes offer a package of help over a set period of time.

What types of investment are there?

Debt:

An investor puts some money into your organisation and they want to get that money back, often with interest. The first questions to consider with all debt-based products are:

a) Will you be able to repay the loan? And;
b) What will happen if you can't repay the loan?

Types of loan:

Secured Loans: These work like mortgages on a house: an investor provides your organisation with a loan against an asset (often a building or equipment) as 'collateral'. You repay the loan on an agreed basis (e.g. regular monthly payments) often including interest on top of the capital repayments. If you don't repay the loan, the investor may have the right to take possession of the asset and sell it to recover the debt.

Pros: Interest rates may be lower than unsecured loans
Cons: Risk of losing your building or asset if you can't repay the loan
Social consideration: Can social investors offer you a better deal than a high street bank?

Unsecured loans – an investor provides your organisation with a loan that isn't secured against an asset. You repay it on an agreed basis, often with an agreed amount of interest on top. If you don't repay the loan, the investor can take you to court to recover the debt.

Pros**:** You don't need to own an asset to get one.
Cons*:* Interest rates are likely to be higher than a secured loan, as it is more risky.
Social consideration: Is the investment helping you create more social value and do more good?

Quasi-equity – this is a debt-based product which is more flexible than a normal loan and acts a bit like equity (hence the name), with some similarities to an investor buying shares in a business. Rather than paying back a set amount each month, your repayments are based on the performance of the business – such as profit or turnover. This model can be particularly useful if your organisation is a charity or Community Interest Company Limited by Guarantee, which cannot sell shares and take equity investment (see below).

Pros: You don't have to repay money you haven't got, the investor may provide additional help and support because they only get their money back if the business succeeds.
Cons: Deals can be complicated to set up; if the business is very successful you may end up paying more back than you would have done with a standard loan
Social consideration: Will the market your organisation works in remain consistent to allow it to deliver consistent profit or turnover over time?

Charity bonds and crowd-funded loans – a loan is a debt to one investor. Bonds are loans made from lots of investors. You can ask a crowd of supporters to contribute towards an overall total loan, through a crowd-funding website or charity bond. This could be a straight unsecured loan or a quasi-equity loan and may also provide non-financial rewards.

Pros: proves support for your organisation, opens up opportunity to general public
Cons: it can take a lot of time and effort to generate relatively small amounts of money; some organisations are more crowd-friendly than others

Equity

An investor put some money in your organisation in exchange for part-ownership of the business. The investor gets a right to share in any dividends which are paid out from profits. They may also sell their shares in the business to someone else as the business grows and those shares become valuable.

It is important to note that most charities and social enterprises cannot and do not sell shares and therefore cannot and do not distribute profits to shareholders. But CIC Limited by Shares, community benefit societies and some other co-operative and company structures can enable some organisations to issue shares and pay dividends within certain guidelines: this means they can still be recognised as social enterprises with a social purpose.

Key questions for enterprises with a social purpose looking to sell shares are:

a) Do you want to give up a proportion of control over your business?
b) Are you going to (or do you want to) make enough profit to give shareholders a return on their investment?

One of the most common types of equity social investment is community shares: the sale of shares in enterprises serving a community purpose. This has been used to finance shops, pubs, community buildings, renewable energy and other community-based enterprises.

Social impact bonds – Social impact bonds (SIBs) are a form of investment product originally developed by Social Finance to make it easier for charities and social enterprises to deliver payment-by-results contracts. Investors in SIBs do not make a direct investment in the charities and social enterprises that are responsible for delivering the contracts: they invest in a special purpose vehicle with a management agent. If the social enterprises and charities deliver the anticipated outcomes, and the expected savings to government, the local or national government pays back the investors with interest.

FAQ

Q. Is a trustee of a VCO personally liable to repay the loan if the project fails to generate the income to repay the loan?

A. No, provided you have acted prudently you will not be personally liable for the loan. You are only at risk of personal liability if you cause loss to the charity by acting unlawfully, imprudently or outside the terms of the charity's governing documents; or committ the charity to debts which amount to more than its assets. However, you should be aware that ultimately the lender may have a charge on the organisation's assets and require them to be disposed of to make repayments due.

Q. My organisation's governing document does not mention borrowing specifically. Does this mean we cannot take out a loan?

A.Not necessarily. You should take advice from the Charity Commission or a solicitor.

Q. How can I minimise the risks associated with taking out a loan?

A. Provide good project management, abide by the terms and conditions, and always communicate clearly with the lender. Providers work to understand an organisation's needs and undertake due diligence before agreeing to any loan.

Resources

- 'Social Investment Explained': SEUK and Big Lottery (2014)
- Report of the Social Investment Impact Forum (2014)
- What is social investment? Know How Non-Profit
- 'Social investment: money for ex-bankers?' Third Sector (April 2016)
- NCVO Social Investment Toolkit NCVO has published a toolkit (January 2015) to support voluntary organisations. It includes useful checklists for organisations to use as they move towards social investment.
- The Social Investment Forum is the national forum for social investment and finance intermediaries. Keep up to date on information and news on social investment via their website.
- UnLtd aims to embed social entrepreneurship within the Higher Education sector, and provides funding to innovative projects with undergraduates/graduates.
- South Bank University School for Start ups runs talks and provides support for existing/past LSBU and the wider community on starting up as an social entrepreneur.

- Social Enterprise UK is a national membership body for social enterprises which provides a range of advice and services to its members, undertakes research, responds to consultations etc.

There are a number of providers who are sympathetic to VCOs. The look for both financial and social return. Different providers take on different levels of risk, focus on different areas and have varying levels of engagement with the voluntary and community sector. Below is a selection of some providers:

Adventure Capital Fund offers a combination of finance and support to community organisations. Its focus is on organisations that are trading or undertaking income generating activities that produce surpluses for reinvestment in the community.

BIGinvest is a large loan fund set up by the Big Issue. Finance is available for commercial property renovation or purchase, equipment purchase, growth or acquistion and working capital.

Charity Bank makes loans available for a wide range of charitable and social enterprise activities.

Co-operative and Community Finance lends to co-operatives, employee-owned businesses and social enterprises. They offer business loans for employee buy outs; delayed grant payments; property or business purchase; capital equipment or working capital; to replace inappropriate existing finance.

Triodos Bank lends exclusively to projects with clear social and environmentall and cultural objectives covering a wide range of actitivies

Venturesome is a Charities Aid Foundation initiatve, providing loans and investment support to charities and other social enterprises.

Social Investment Business is a leading UK social investor which is made up of the charity Social Investment Business Foundation, its social enterprise, the Social Investment Business Ltd and its partners Social and Sustainable Capital.

Big Society Capital receives up to £400 million from the Reclaim Fund Ltd which collects dormant bank and building society account monies from UK banks and building societies. After retaining reserves to cover possible future claims, the Reclaim Fund passes the money it receives to the Big Lottery Fund.

Support

If you would like any support with social investment or any other issues facing your organisation, please contact the Development Team at Community Southwark: development@communitysouthwark.org.uk or 020 7358 7020.