IVAR Institute for Voluntary Action Research

Charities and social investment

A research report for the Charity Commission

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Authorship

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Part One: Introduction

This report sets out the findings and conclusions of a study about social investment as it relates to the needs, governance and regulation of charities. It was commissioned by the Charity Commission, the independent regulator of charities in England and Wales.

In this introduction, we outline the study aims, the methods we used and we explain some of the terms used in this report.

1. Study aims

The aim of the study was to investigate the challenges and opportunities facing charities that are involved in social investment. The study's objectives were to:

- Explore charities' experiences of receiving social investment
- Explore charities' experiences of making social investments
- Gain an insight into, and gauge opinion on, the likely development of the social investment market over the next five years.

2. Study methods

The study findings are drawn from interviews, meetings and facilitated group discussions with the following kinds of organisations:

- 20 intermediary, infrastructure and academic/think tank organisations
- 25 charities that have received social investment (chief officers and trustees)
- 25 charities that have made social investments (senior managers, trustees).

Throughout the report we use 'participant' to refer to all those who took part in the study through interviews, meetings, group discussions or written submissions.

Wherever possible we provide a synthesis of the data, but where experience and opinion diverged considerably we describe them separately.

3. Use of terms

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:[1]

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

This study does not cover other types of financial investment that charities can be involved in, including ethical investment.

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[1] Charity Commission (2011) *Charities and investment matters: A guide for trustees (CC14)*, London: Charity Commission

Where we refer to *'charity investees'* we mean charities that have received investment as described above, excluding grants or contracts, although most will also be in receipt of these. Where we refer to *'charity investors'* we mean charitable trusts and foundations that make investments and are themselves charities, although the organisations they invest in may not all be charities.

By *'intermediaries'* we mean organisations that have received investment from charitable trusts and foundations for onward investment. Some of the intermediaries we spoke with are themselves charities, subsidiaries of charities or co-operatively owned. We use *'non-charitable intermediaries'* to refer specifically to those intermediaries that are not charitable.

Part Two: Background

In this part of the report, we provide a brief overview of social investment as it relates to this particular study, which focused on charities. Our aim is to provide sufficient context and background for readers unfamiliar with social investment to engage with the study's findings. Where appropriate, we reference other literature and research that offer a broader review of the field.

4. Charities and social investment

For more than a decade the UK government has been keen to support the development of a social investment[2] market. In April 2010 it set up the Social Investment Task Force (SITF), which made a number of recommendations, some of which have been implemented, for example, the introduction of Community Investment Tax Relief. Since 2010, the coalition government has introduced a range of policies designed to further stimulate the market. These include launching Big Society Capital, providing £100m to the Social Enterprise Investment Fund and supporting social impact bonds.

Total social investment in the UK in 2010/11 has been estimated at £165m, of which 70% was made by the four social banks (Co-operative, Triodos, Unity and Charity Bank)[3]. Intermediary investors managed funds ranging from just over £2.5m of government funds, for direct lending, up to £600m of wholesale funds. Most lending was for land or property purchase, construction or renovation and was secured[4]. For these reasons, social investment is generally described as an emerging market[5] and, while research suggests that there has been an increase in the supply of social investment, demand for social investment finance remains limited.

There is little research about the first hand experiences of charities either making or receiving social investment. The small amount of UK research and evidence that exists tends to focus on the factors that affect whether or not a charity may choose to engage with social investment. For example, in Lord Hodgson's review of the Charities Act 2006, he highlights nervousness among trustees, a culture of risk aversion, a lack of affordable 'off-the-shelf' investment products and uncertainty about relevant legal, tax and other regulatory constraints.[6]

Factors influencing demand for social investment have also been identified. They include whether or not an organisation is 'investment ready', understanding risk,

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[2] Understood as the application of investment finance to generate both social and financial returns. But see also, Big Society Capital (2012) 'What is social investment' [online]. Available from: www.bigsocietycapital.com/what-social-investment [Accessed 18.9.2012]; Everett, R. and Richter, K. H. (2011) *Making good in social impact investment: Opportunities of an emerging asset class*, London: The Social Investment Business and TheCityUK; Gregory, D., Hill, K., Iona, J. and Keen, S. (2012) *Investment readiness in the UK*, London: Big Lottery Fund.

[3] Brown, A. and Norman, W. (2011) *Lighting the touchpaper; Growing the Market for Social Investment in England*, London: The Young Foundation.

[4] Ibid, p12

[5] See for example, Ludlow, J. and Jenkins, J. (2011) *Twenty catalytic investments to grow the social investment market,* London: NESTA; Social Investment Task Force (2010) *Social investment ten years on: Fnal report of the Social Investment Task Force*, London: SITF.

[6] Lord Hodgson of Astley Abbotts (2012) *Trusted and independent: giving charity back to charities. A review of the Charities Act 2006*, London: The Stationery Office Ltd.

improving commissioning practice, exploring opportunities to blend grants and investment finance[7].

CAF Venturesome, a social investor, takes a slightly different approach and instead identifies four factors that it believes are critical to the creation of a *'responsible and intelligent social investment market'*: resilient supply of finance, a confident and informed civil society, efficient matching of supply and demand, and a variety of investment mechanisms.[8]

5. Benefits and challenges of social investment

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 sector is thought to be undercapitalised currently because of legal barriers to charities obtaining capital (e.g. not able to distribute profit), historical reliance on reserves, perceptions that investment in charities is risky, low levels of earned income and a lack of management capacity in charities.[9] It is argued that social investment has the potential to encourage innovation, enable social impact[10] and support income diversification at a time when the need for alternative finance is likely to rise.[11]

A wide variety of challenges have been associated with social investment. For example, the limited track record of successful investments, organisational culture in charities including risk aversion, the current economic environment, and the legal and regulatory framework within which investment takes place. It has also been suggested that financial products need to accord with the values and ethos of the sector, and that this may be difficult to sustain as the market grows. There is a view that voluntary, community and social enterprise (VCSE) organisations, including charities, typically operate in the wake of market failure and that, therefore, few organisations are likely to generate profits of a scale that would interest commercial investors.[12]

6. The role of the Charity Commission

In 2011, the Charity Commission, the regulator of charities in England and Wales, revised its investment guidance to reflect the growing interest in social investment. The updated guidance, *Charities and investment matters: a guide for trustees (CC14),* covers a range of different types of investment and clarifies the Commission's policy on social investment. As explained in the introduction to this report, the Commission identifies two types of social investment, 'programme related' and 'mixed motive'.

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[7] Brown, A. and Norman, W. (2011) *Lighting the touchpaper; Growing the market for social investment in England*, London: The Young Foundation.
[8] Charities Aid Foundation (2010) *Financing the Big Society: Why social investment matters, A CAF Venturesome working paper,* Kent: CAF.
[9] See, for example, Ludlow, J. (2010) *Capitalising the voluntary and community sector: A review for the NCVO Funding Commission*, London: NCVO; Gregory, D. et al (2012) *Investment readiness in the UK*, London: Big Lottery Fund.
[10] See note 8.
[11] Moulin, S. et al (2011) *Growing interest? Mapping the market for social finance in the youth sector,* London: The Young Foundation.
[12] Senscot (2012) 'Social investment in Scotland: A discussion paper' [online], Available from www.senscot.net/view_art.php?viewid=12660 [Accessed 3.9.2012]

Charities and investment matters describes the legal duties and principles that apply to charity investments and the risks that trustees must address. It offers a framework for decision-making, but the Commission emphasises that it is up to trustees to decide on the most appropriate overall investment strategy for their charity. The guidance also explains that trustees must be clear about the purpose behind their investments and be able to account for their decisions. For example, charitable foundations cannot make an investment with below market rate of return in areas that fall outside their mission.

Part Three: Study findings

In Part Three, we present the findings from our research about charities and social investment, commissioned from the Institute for Voluntary Action Research by the Charity Commission. The study findings are based on interviews with intermediary, infrastructure, academic and think tank organisations as well as with charities that have received social investment (investees) and made social investments (investors).

We provide a summary of key findings in three areas, before exploring each in further detail.

7. Summary of key findings

The experiences of charity investees

- There were several factors contributing to success in securing and managing social investment. These included having an engaged board, confident and skilled management, effective business planning, a reliable revenue stream and a strong asset base. Strong relationships between investors and investees, based on mutual trust and a shared vision and strategy for what the investment would achieve, were also seen as crucial.
- The charity investees in this study cited several areas in which they had needed support to enhance skills and capacity in order to be ready for investment. These included the provision of independent advice, tailored support with business planning, peer learning with other charity investees and simple, clear and accessible investment products.
- Many of the research participants agreed that there was general nervousness about loan finance on the trustee boards of charity investees. The investees themselves felt this wariness caused the trustees to take a responsible and risk-based approach. Social investment intermediaries, on the other hand, felt that charity investees were being excessively cautious and missing opportunities for organisational growth and greater social impact.

The experiences of charity investors

- Charity investors described several benefits of social investment. These included achieving social impact, providing capital to financially excluded organisations and communities and offering alternative forms of finance to their beneficiary organisations.
- The main risks of social investment were seen as incurring a financial loss and thus damaging the investor's reputation. Charity investors were also concerned that social investment might not be as effective as making conventional investments and spending the revenue from that on grants.
- Most study participants were aware of the Charity Commission's guidance on social investment but awareness was higher in England than in Wales. The guidance was praised for having improved understanding among charity investors, although there was a general preference for the programme related investment model over mixed motive.

The development of the social investment market

- There is evidence of a lack of shared understanding between organisations and sectors in the social investment field which currently impedes its

development. Some intermediaries were often unaware of the legal and regulatory obligations that charities face when it comes to making and receiving investment. They also complained of poor financial skills and risk-aversion amongst charity investees. Charity investees, for their part, said that some intermediaries lacked sufficient insight into and experience of the charity sector to be in a position to assess social impact properly.
- Participants cited major drivers in the development of a successful social investment market from a charity perspective. These included closer collaboration and stronger relationships between investees, investors and intermediaries. It was also felt that social investment should not undermine public confidence in charities.

8. Charities seeking and managing social investment

In this part of the report, we set out our findings about charities seeking and managing social investment under the following four headings:

- Motivation
- Success factors
- Barriers and risks
- Advice and support.

We spoke with chief officers, trustees and senior managers in 25 small and medium sized charities. Most of these operate across a single district or region although four operated nationally. The organisations are engaged in a range of areas including sports/recreation, the arts and education. For a more detailed description of the sample please see Appendix Two.

8.1 Motivation

Charity investees and investors described social investment as *'a useful alternative'* to grants and public sector contracts in a charity's mixed portfolio of funding and thought it widened the pool of potential investors in their organisation. Charities that rely heavily on donations from wealthy individuals said that new and different individuals came forward when they asked for investments as well as donations.

In England, and especially in Wales, charities were thought to be mainly aware of and interested in simple debt finance. Where charities had begun to consider trading options, their ambition generally remained simple: to secure debt finance, set up a profitable trading subsidiary, and transfer profits to the charity.

The main factors leading to them choosing a loan were: seeing this as a last resort after failing to secure a grant or contract, lacking the skills and capacity for more complex investment, and concerns about charity law and regulation that had put them off options such as quasi-equity finance.

For all of the above reasons, a minority of study participants questioned whether it made sense to consider loans alongside other kinds of social investment. These participants felt that some social lenders *'mystify'* investment, including loans, making the processes involved unnecessarily complicated.

Overall, motivation to engage with social investment fell into two distinct but related categories: investment for strategy and investment for adaptation or survival.

8.1.1 Investment for strategy

Where participants thought that their organisation needed to engage with social investment in the long term, they offered several reasons. First, they perceived a fundamental shift in the way VCSE sector organisations are funded and thought that their organisation would need to change in order to succeed:

> *'Politically it won't ever be the same again. We're pitching ourselves in that mould* [investment ready] *so that we're ready.'* (Charity investee)

> *'Grants are increasingly difficult and come with demanding requirements. The next big pot of money is debt finance, which charities were traditionally*

> *averse to. They are now looking at generating income stream, and some are setting up profitable trading subsidiaries and transferring the profits into mainstream charities.'* (Intermediary)

Second, they saw investment as more efficient and cost effective than grants. This was particularly the case if large sums needed to be raised, which would require paying fundraisers over a long period of time, for example, raising money to purchase a property or carry out major refurbishment.

Third, a small number of participants felt that a loan enabled them to retain their independence and focus on their mission and strategy. These participants secured investment to support new ways of working in their organisation and/or local area. They talked about social investment as part of wider economic change. For example, one organisation that operates in a small geographical area sought funding in order to improve their building. This enabled them to provide a shop where none had previously existed, increase footfall into the existing community and health centres, and provide local employment for *'disadvantaged adults'.* Another charity sought investment for a subsidiary organisation which would market their services and generate a profit, to be reinvested into the core business. Both of these examples were described as innovative and risky; they would need long-term investment and a willingness to risk making a loss initially or even failing completely.

A number of intermediary organisations saw investment as part of a wider change in the way an organisation operates. They focused mainly on growth and scaling up operations to do more in pursuit of charitable aims. They saw investment as helping charities with *'the bottom line'*, rather than programmes, and as a way of releasing charities from the *'stranglehold'* of grant funders, which are more traditionally associated with programme funding.

8.1.2 Investment for adaptation or survival

Some participants had sought social investment to help them finance their way through a problem such as cash flow. Investment had not necessarily been their preferred funding option and was quite explicitly linked to organisational survival.

For example, one charity wanted investment to cover their director's salary for a short period while he focused on the organisation's future direction and funding strategy. Two other charities faced sudden closure unless they could secure premises for their work.

For many of the charities that fell into this broad category, social investment was a one-off and they had no expectation of taking future loans. These charities described investment as a *'stepping stone'* to achieve a specific objective, for example, upgrading some of their equipment or facilities so that they could be hired out and generate a small income for the organisation.

8.2 Success factors

We asked study participants what had helped them to secure investment. Below we set out the main themes that emerged: governance, leadership, shared vision, business plan, assets and resources.

8.2.1 Governance

Most study participants (including charities and lenders) described trustees as nervous and wary about investment, at least initially: *'they just don't equate charitable organisations* [with] *owing money'.* They were concerned about their organisation's reputation, they were uncomfortable with trading and *'making money'* from other VCSE organisations, and worried that it would be hard to attract new staff and trustees to an organisation with a large debt. Communicating and explaining the decision to seek investment to donors and beneficiaries could be challenging, they said, and might adversely affect their ability to secure other forms of income. Study participants also commented that some charities simply did not want to be the pioneers of social investment and would prefer to let others take the risk initially.

Charity investees perceived trustee nervousness as positive: it ensured that the organisation proceeded with caution and carried out thorough research and risk assessments: *'the board agonised for two meetings about whether to take the loan'.* They saw such nervousness as problematic only if it meant that trustees were unwilling to even consider investment as an option alongside other possibilities.

Investment intermediaries perceived such nervousness negatively. They felt that trustees were mainly interested in stability rather than growth. This was perceived by some intermediaries as being linked to a lack of interest in social impact.

Key factors in trustees being willing and able to engage with investment were a skilled board, a regular turnover of trustees and an engaged board that understands the organisation's direction (and can therefore understand the rationale for seeking investment). Participants made a distinction between a skilled board, comprising a group of individuals with relevant skills and experience, and an engaged board, where these skills and experience are usefully deployed in the organisation's work. One participant who said that their board had been helpful to the process, described it as:

> *'A small, diverse board that understands our mission and direction and also understands the plan for the local area. They understood that we would need to find alternative funding to achieve that plan.'* (Charity investee)

8.2.2 Leadership

The process of securing social investment tended to fall to a small number of individuals who were passionate about their organisation and its future prospects. Typically, this would be the chief officer, chair or a trustee or senior staff member. Participants agreed that securing social investment requires commitment and persistence, time and a willingness to acquire new skills, all underpinned by devotion to the organisation's mission and its beneficiaries.

> *'It really does come down to how committed you are. Is the group committed to what they said they are going to do … If they have that, fair enough, if they haven't I would be very cautious.'* (Charity investee)

Study participants also identified as critical a confident, passionate and committed management team that takes seriously the need to make a business case, that understands the distinction between investment and grants management, and that possesses the necessary financial skills to manage investment. They also needed to have, or be in a position to buy in, legal expertise.

How charity investees responded to this need for commitment varied, with small organisations that took part in the study in particular saying that investment placed a considerable burden on them:

> *'I* [chief officer] *was the driving force. The trustees supported me* [but] *they did leave me to it. It was a nightmare. I had never done anything like that before. I felt a huge responsibility to staff and parents. I had to do it. I didn't have a life … You just get on with it.'* (Charity investee)

> *'It was an onerous time but we got there.'* (Charity investee)

One function of leadership in this context was to help staff and trustees explore new ways of thinking about their organisation's future. One charity investee explained this shift in the way his organisation thinks with the following example: *'we are becoming more efficient as a tenant in our own building'* and described how they had assessed how well each room and even desk was being used before deciding whether extra space could be rented out.

Study participants in intermediary organisations were even more likely to suggest that a wider philosophical change needed to take place:

> *'Charities and social enterprises have a way of spending their profits. Tends to be an institutional mindset, if we generate surpluses, we should spend them on our beneficiaries – reduce prices or roll out new free service. Profit maximisation is not in the mindset. If investment returns are dependent on surpluses, that can be a source of tension.'* (Intermediary)

8.2.3 Shared vision

A number of study participants talked about the importance of charities having a vision for their investment. Where a charity's vision aligned well, not only with its own mission but also with its investor's mission, participants identified the potential for a strong partnership between them. Charity investees also said that a charity seeking investment must be able to think five to 10 years ahead. The importance of charity vision is related to our findings about charities seeking investment for strategy (see section 8.1.1 above).

> *'Social investment is not for everyone. A lot of organisations can't think more than 12 months ahead and don't have the capacity to engage with social investment. It takes a long time to make a compelling case for investment.'* (Charity investee)

> *'The loans run over 20 years which is a short time for an organisation like this one. Once we have repaid the loan the organisation will have the resources to earn money. This is part of a long-term vision.'* (Charity investee)

Several charity investees said that they had sought investment for a long-term strategy or vision for their local area or organisation. As such, the strategy was well researched, had the support and understanding of local people or other relevant stakeholders and was expected to bring about a widely desired change.

> *'We already had proposals to which the board was committed, there was a wanting to do the scheme among local people and a helpful local architect.'* (Charity investee)

8.2.4 Business plan

In order to secure investment and be in a position to manage it, charities needed a thoroughly researched business plan, and in order to achieve this, most organisations needed some financial and bespoke support.

> *'Fundamentally it's about being investment ready. Having a robust business plan – that covers what they do, why they do it, who's involved, what their social mission is and what they are looking for money for.'* (Intermediary)

Participants suggested that a business plan needed to be backed up by a track record in service delivery or facilities management. Furthermore, they needed to be able to articulate this business plan in ways that would appeal to multiple audiences, including lenders and the private sector. This marketing role generally fell to the organisation's chief officer.

8.2.5 Assets and resources

Study participants thought that having assets in the form of money or property was critical to successful investment. Assets made investors more willing to lend and trustees more confident about the risks of investment. Although several charities had assets in the form of equipment (such as sports equipment), the main assets of interest in this context were buildings and/or significant reserves (sometimes held by a parent charity), built up over time or as a result of a single large donation. Several participants said that an unexpected bequest or major donation had been the catalyst for taking on the risk of investment.

Finally, in addition to the lack of an asset, the lack of a '*quality revenue stream'* [13] was thought to be a major barrier to securing investment. Help with business planning had been a critical factor in this respect.

8.3 Barriers and risks

Study participants identified a range of barriers and risks related to investment. These covered the investment process, lack of understanding between investors and investees, limited access to legal and business planning support and the perception of risk.

8.3.1 Problems with the investment process

Study participants with experience of receiving investment identified four important features of the process. First, charity investees welcomed the lenders' scrutiny of their organisation as this helped them to assess risk and feasibility with their board. Second, they said that lenders did not always articulate clearly at the outset what the process would be and what kinds of evidence or information they would need; this placed a considerable and unforeseen burden on small organisations. There was a perceived lack of clarity and transparency about some investors' assessment, due diligence and reporting requirements along with a perceived failure to tailor these to individual organisations. Third, charity investees said that, based on their experience, it is essential to be *'serious', 'thorough' and 'cautious'* about investment, for example

[13] Income, from an identified source, that is timely, reliable, steady and with potential to grow over time.

by forecasting growth based on the most conservative financial projections. Fourth, participants identified a difference between securing an investment rather than a grant:

> *'Organisations benefit from the process of securing investment. Whereas grants are all about what happens before all the money is spent, i.e. the benefits of what they are doing and the costs, investment focuses on what happens once all the money has been spent.'* (Intermediary)

Finally, one charity investee said that, if seeking investment again, she would ask an investor organisation the following questions: *'What is the normal time frame for making a decision about a loan? What is the breakdown of what you will need from me? What is the process?'*

8.3.2 Lack of understanding

Underlying our conversations with charity investees, investors and intermediaries were their perceptions of one another. We found that charity investees thought that charity investors and intermediaries needed more *'patience'* while charity investees adapt to the requirements of investment and learn a *'new vocabulary': 'There is still a lack of understanding that a lot of organisations are still learning the process of standing on their own two feet'.*

When we spoke with intermediary organisations, we found that they placed greater emphasis on business planning and less on mission, vision and values. Participants focused on a need for *'discipline'* in the way charity investees prepared for and then managed investment, a need to be willing to think about ways to generate a profit, as well as the legal and financial skills and capacity they will require.

8.3.3 Limited access to legal and business planning resources

Study participants expressed their concern about charity investees' ability to obtain good quality legal advice and services. Charity investees faced a dual challenge: legal advice is expensive, and local solicitors may be unfamiliar with the way charities operate. They resolved these difficulties by: securing pro bono support (usually from a local firm known to the board of trustees), placing their trust in the lawyers working in the organisations with which they were negotiating (e.g. an intermediary body or local authority where a community asset transfer was part of the transaction), or by obtaining a grant to cover the initial costs of securing investment.

8.3.4 Perceived risks and unforeseen pitfalls

When considering whether or not to take investment, participants said that the main question they asked themselves was: *'Can we repay the debt?'.* This led them to consider several further questions:

- Are our projections about future earned income accurate and realistic?
- Are our predictions about future grants and contracts realistic?
- What are the implications of reduced public expenditure and increased competition for contracts within the VCSE and with the private sector?
- What might be the consequences of staff changes (and loss of relationships) in either our own organisation or in one of our main funder organisations?
- Will the asset we propose buying hold its value so that we can sell if we need to?

- How confident are we of our ability to deliver the services or facilities?

After addressing these questions, several organisations took the decision to ask for a smaller amount of investment than originally envisaged. For example, one charity scaled back their building renovation plans and chose to prioritise the facilities that would help the organisation generate a quick financial return. Another charity decided not to pursue an investment (they later sought investment from a different lender) because of the high rate of interest:

> *'Always be able to cover your debt. If we had taken the full amount originally envisaged we might have been in difficulties. But if something happened now we would be able to pay our debts.'* (Charity investee)

We asked charities to tell us about the risks that transpired after they had secured an investment.

- Payment by Results[14] had placed a considerable financial burden on organisations. Participants said it needs to be part of a mixed portfolio of funding.
- Organisations that took loans to develop or buy an asset from which they expected to generate a rental income have been affected by the economic downturn and by cuts in public expenditure.
- Organisations affected by these changes find themselves with empty desks and office space to fill. One organisation was investigating the possibility of renting to commercial organisations but trustees were cautious about the idea, in part because they thought that the organisation would be going outside its charitable purposes.
- Organisations faced cash flow problems when rent from tenant organisations was late or unpaid because a tenant organisation had closed or was experiencing financial difficulties.
- Demand for new services or facilities had been lower than expected or bookings were fewer than anticipated.

8.4 Advice and support

Our findings suggest that advice and support for charities considering social investment is unevenly distributed across England and Wales and that its quality is *'variable'* and *'questionable'.* Charities in Wales appeared less likely than charities in England to be proactively seeking advice about social investment, but demand for advice was not thought to be high in either country. Intermediary organisations said that charities that had already obtained some advice before approaching the intermediary still required a considerable amount of further advice before formally seeking investment.

From our interviews with charity investees, we identified three stages during which advice and support is required.

[14] Charities Aid Foundation (2012) *Funding Good Outcomes: Using social investment to support payments by result*, London: CAF.

8.4.1 Making the case for investment: 'new thinking' stage

Having a business plan and being able to make a convincing business case for investment were thought to be critical to securing investment. Most of our participants had been able to get to this point through a combination of financial and bespoke support from a skilled individual. Financial support came in the form of a small grant from a local authority or trust or as a result of receiving a large grant from the Big Lottery Fund (BIG), which required them to become more outcomes-focused and gave them the time and resources to achieve this. Charity investees gave several examples of a legacy effect of this financial and bespoke support: one chief officer who had found the investment process stressful and challenging said: *'she* [business adviser] *stayed with us through the process and now she is one of our trustees'.* Another participant said that BIG's requirements left their organisation better equipped for business planning having required them to *'think* [more] *clearly … what we were going to achieve and how we were going to monitor that'.* Echoing this point, another participant said: '[the] *lottery made me become investment ready.'*

8.4.2 Finding out about social investment: assessment stage

Study participants suggested that most charities are not considering social investment but remain focused on grants and contracts which they can find out about through their own networks or established infrastructure support. They did not think that most charities know where to get advice on investment. It was also suggested that charities without investment experience may not know how to use or interpret such advice.

Participants described finding out about the possibility of investment by chance through staff, trustees or existing networks. A small number had sought information from their membership body, but most participants had not used membership or other infrastructure support in this context. Mainly, they sought information from the lender or intermediary with which they then negotiated their investment. While considering the possibility of investment, some participants had approached the Charity Commission for clarification on technical and legal issues related to their own organisation's structure.

8.4.3 Managing the investment: partnership stage

Once an organisation has secured investment, study participants emphasised the need to tailor support to an organisation's needs and build a long-term relationship between the investor and investee organisations. This was in their interests as they were now 'locked in' to an arrangement where success benefited both organisations. Several community organisations emphasised the benefits of their relationship with a local charitable trust from which, over the years, they had received a mixture of small grants and loans as well as advice and support. For example, a charity that offers sports facilities had received financial and other support on two separate occasions to help with cash flow, to renovate small parts of the overall facility and to help lever in funds from other sources.

Participants were enthusiastic about the annual review conducted by their lender where the investment would be reviewed alongside issues and challenges facing their organisation. While they recognised that their lender's primary motivation is to ensure that their money is repaid, participants said that the combination of *'a hard headed business approach and a sympathetic ear'* was welcome and practically useful. Unexpected benefits included having someone else to talk to about the challenges involved in managing property or business contracts.

Finally, study participants suggested several ways to make more advice and support available: small financial grants to help organisations get started, opportunities for peer learning, and schemes for business staff to volunteer their time to advise charities (e.g. RBS Nat West corporate social responsibility scheme). They also thought that grant-making organisations such as trusts and foundations might have a role to play in helping charities to become 'investment ready'.

9. Charities making and managing social investments

In this part of the report we present our findings about charities that make and manage social investment. We include the views expressed by charitable and non-charitable organisations engaged in making social investments in charitable organisations. We found that the experiences and opinions of charitable and non-charitable investing organisations diverged in ways that our study participants thought were important because of their impact on the market's development.

Before setting out our findings in detail, we describe briefly the investment organisations that took part in the study. We spoke with 25 charitable trusts and foundations either individually or as part of the informal Social Impact Investors Group. We also spoke with representatives from eight social investment intermediary organisations, five of which were themselves charities, subsidiaries of charities or co-operatively owned. Charitable social investment intermediaries had been operating for an average of 13 years and non-charitable intermediaries for six years. Key characteristics of the people and organisations we spoke to included:

- Non-charitable intermediaries have not yet made a substantial contribution to social investment in charities, although they have developed innovative products. They attached less significance to whether or not an organisation they invest in is a charity regulated by the Charity Commission.
- Charity and related intermediaries talked about helping charities to pursue their mission and strategy for the benefit of beneficiaries while non-charitable intermediaries were more likely to emphasise the potential for scale and replication as part of wider aspirations and expectations for the role and shape of the VCSE sector.
- Assessment of social impact also differed between the two groups, with charity intermediaries more likely to rely on impact data collected over time by investees, rather than projections of social impact thought to be achievable if an investment was made.
- Some charitable trusts and foundations expressed concern that non-charitable investment intermediaries lack an understanding of charities' culture, roots or terminology as well as the legal position of charities in relation to social investment.
- Charitable organisations felt that there was some hype in the social investment market and a mismatch between *'the new breed of intermediaries'* and market needs.

Below we set out our findings in detail under three headings:

- Making social investments: skills, barriers, support requirements
- Assessing the benefits and risks
- Guidance on social investment

9.1 Making social investments: skills, barriers, support requirements

9.1.1 Scale and type of social investments

Among the charitable trusts and foundations that we interviewed, investments to date ranged from between £1.5m to just over £20m per trust, with the proportion of endowments committed to social investment ranging from 2.5% to 40%[15] of total endowments. A wide range of investment types have been used, including direct and intermediary investments, equity, quasi-equity, secured and unsecured loans. Investment sizes range from £20,000 to £1m. Total investments among the charitable trusts and foundations that we interviewed were estimated to amount to less than £50m.

Charity investors were very clear about the connection between social investments and their contribution to mission. A number of participants expressed particular interest in investing in organisations that had previously received grant funding and where there was *'a track history of a relationship';* others saw social investment as *'a logical extension'* of the ethical and responsible investment of their endowment.

9.1.2 Skills and capabilities required to manage social investment

Study participants in charitable trusts and foundations identified the balance between financial skills and mission-related capabilities as crucial in initiating and managing social investments. Generally, trusts expressed confidence in their own capacity to understand and make decisions about mission and social impact. However, they tended to rely on external expertise to assist with assessment of financial risk and return.

Study participants in intermediary organisations suggested that the skills and capabilities that charities needed to manage social investments successfully were:

- Financial analysis - banking skills
- Social impact analysis
- Investment management experience
- Financial risk identification and mitigation skills
- Market analysis
- Governance and management team analysis.

9.1.3 Barriers to making investments

Charity investors and non-charitable intermediaries had different views about the barriers to investment, partly because of the different roles that they occupy in this market.

The views of charitable trusts and foundations

Most of the study participants in charitable trusts and foundations said that they had not reached their current limits for social investment and could do more. There was some scepticism about recent projections of market size.

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[15] The larger proportions tend to apply to very small trusts.

A number of charity investors highlighted the effects on the market of poor contact between investors and investees: *'The needs of charities are mostly very simple, cashflow or capital to buy a property ... It's unclear what investors want to invest in*'. Another trust suggested that the amount of capital available does not match the demand from charities and social enterprises for patient risk-capital[16]. Making non-standardised or 'one-off' social investments is more expensive for trusts than making grants as transaction costs, monitoring and evaluation cost more. The need for an exit strategy for investors to enable them to get their money back and the establishment of a secondary market are viewed as key building blocks in developing the social investment market.

The views of intermediaries

Intermediaries perceived the following barriers to making investment: trustee risk-aversion, patchy infrastructure support, the need for culture change in charities, lack of investment readiness, lack of commercial and financial skills and weak balance sheets.

9.1.4 Requirements for support

We found that opinion about, and experience of, investment support also diverged.

The views of charitable trusts and foundations

Most charitable trusts and foundations interviewed said that they buy in advice from firms such as Social Finance or from individual investment advisers, particularly to carry out financial risk and return analysis and due diligence processes. However, some prefer to manage those processes in-house, seeing them as part of a continuum between grant-making and managing their endowment. Legal services were most likely to be bought-in and could also be shared between co-investing trusts.

The views of intermediaries

Intermediary organisations that offer support to social investors identified the need for specialist social investment advice that could not be provided by traditional asset managers. Integrating impact assessment into the investment process was also seen as an area where charity investors might need support.

A number of interviewees stated that the larger trusts and foundations had the skills and experience necessary and were happy to work with others to develop processes for syndicated deals[17], rather than individual assessments. Support may be required for sharing learning and for developing standardised products and legal documents.

9.1.5 Social investment in charities and non-charities

All of the charitable trusts and foundations interviewed had the power to invest in organisations that were not charities and had previously done so, although one trust stated that it would not make a social investment into an organisation that *'makes*

[16] Money invested at risk by investors who are willing to trade financial return for social impact and to wait longer for the return of their capital.
[17] A loan or investment offered by a group of investors called a syndicate, who work together to provide funds for a single borrower.

and distributes a profit to private investors'. Another felt that '[when making a social investment] *it gives a foundation comfort if something is a registered charity*'. Study participants made the point that many charities set up social enterprises that sit alongside them or have community interest companies as their trading entities. It was felt that social enterprises, co-operatives and community interest companies are more likely to want investment than charities. As new organisational forms develop, questions may arise about where Charity Commission regulatory oversight meets the oversight of other regulators.

Charitable status was not a factor for non-charitable intermediaries in making decisions about whether or not to make a social investment. Most were not immediately aware of whether their clients were charities, although they were very clear about their mission and social impact. Those intermediaries that are themselves charities were more likely to know which clients were charities.

9.1.6 Potential for collaboration and co-investment

All the charity investors that we spoke with were members of the Social Impact Investors Group, which meets regularly to share experience and learning and seeks to support the development of social investment among charitable trusts and foundations. Participants identified a significant amount of collaboration, supported by a strong desire for co-investment: *'Most would rather do 10% of 10 deals than 100% of one deal. It allows them to mitigate risk and also share the brains.'*

9.2 Assessing the benefits and risks

9.2.1 Assessment of social investment opportunities

Study participants were asked about the way they assess investment opportunities and what informed their decisions. Overall, they stressed the importance of well-researched proposals that present a strong business model and demonstrate awareness of the need for good financial management including clearly identified risks: '*The numbers* [financial projections] *must stack up'.*

Specifically, study participants said that they focused on the following features of investment opportunities to help them to decide whether or not to invest:

- The investee charity's mission and objects: Are they clear? Do they align with the investor's own mission and objects?
- The likely social impact of the proposed investment.
- The business plan and the business skills and experience of the management team behind it.

Views diverged about social impact assessment, its meaning and what kind of expertise was needed to carry it. While all intermediary organisations appeared to be confident of their capacity to assess social impact, some organisations with a financial specialism did not seem to have the same levels of expertise in the field as those with a charity or VCSE background. There was a lack of clarity among these organisations about whether they were assessing social impact retrospectively (based on a logic model or theory of change and impact indicator data collected and analysed over time), or prospectively (also based on a logic model and theory of change but with the intention to collect impact indicator data in the future). It was thought that a focus on 'impact targeting' comes more readily to charity investors, as they concentrate their investments in the most deprived areas of the country.

9.2.2 Benefits and risks

Views of charitable trusts and foundations

Study participants in charitable trusts and foundations saw social investment as another 'tool' to sit alongside grants and felt that charitable trusts and foundations needed to be aware of its potential. However, participants also commented that social investment may not be appropriate for all organisations, either as investors or investees. The benefits of social investment were summarised as:

- Using assets more effectively and achieving multiple impact
- Contributing to mission by making positive use of capital
- Investing ethically
- Making capital available to organisations that might not otherwise be able to access it
- Achieving social impact without spending down the endowment
- Providing alternative finance opportunities for beneficiaries.

The principal risk identified by charitable trusts and foundations is that of losing money and the effect of this on the value of their endowment. They also shared two other concerns. Firstly, risks to reputation - both the reputation of the trust or foundation and that of social investment as a relatively new and under-developed field. Secondly, the risk that the investment might or might not be effective: would charitable trusts and foundations in fact achieve more by investing their funds conventionally and spending the revenue generated on grant-making?

Views of intermediary organisations

Intermediary organisations assessed risks and benefits from a different perspective. They identified the key benefit of social investment as delivering social impact while the money is recycled. They also suggested that social investment complements grant-making, as it can be used with organisations for whom a grant is not necessary or appropriate. The potential for social investment to help *'create a market in sustainable funding'*, so that more impact could be achieved and more social issues resolved was highlighted, alongside possible reputational benefits: *'it's a growing market, so it's good to be involved'.*

The main risk of social investment as perceived by intermediaries was similar to charity investors: losing the investment and, potentially, damaging a charitable endowment. Linked to this, concern was expressed about the fact that many social investments are illiquid: *'you can't get your money out if you need it'.* There are also legal risks where charity trustees fear being held accountable for decisions that, with hindsight, turn out to have been wrong. For example, an interviewee from a membership organisation highlighted the need for new and different skills both to make the investments and to assess social impact and felt that there was a risk to the organisation and its effectiveness as a result. Finally, reputational risk was identified, particularly in relation to failed investments where the investee relationship broke down.

9.2.3 Different social investment products

In an emerging market, participants perceived a need for a variety of investment products, including simple loans and standard legal and other procedures in order to draw in charity investees for whom this kind of charity finance is unfamiliar and to keep legal and other professional fees to a minimum.

The study found that charitable trusts and foundations already involved in social investment perceived a role in helping to develop the emerging market. Some said they were particularly interested in innovation and described themselves as *'early adopters'.* For example, charitable trusts and foundations are supporting the Peterborough Social Investment Bond and the Social Stock Exchange: *'We're very associated with trying to catalyse the marketplace'.*

In spite of a considerable amount of innovation, participants said that there were still *'not a lot of products out there'.* Charitable trusts and foundations that are already involved in the market believed that, as more charitable trusts and foundations get involved in social investment, safer, less innovative products would be needed. They could also see the attraction for both charity investors and investees of *'simple, conventional, understandable products … that the public can understand'.* For small organisations, participants thought that *'simple'* meant loans. They also noted, however, that larger, more sophisticated charities were looking at issuing their own bonds. These products can be simple, easy to understand, safe and offer a good return.

Finally, participants suggested another way to keep down legal costs and appeal to the general public. They said that getting *'ordinary money'* from individuals (e.g. Charity Bank ISAs) into the market as well as corporate money (e.g. pension funds)[18] would be a challenge but, if achieved, would make a difference in this respect, because they would use a recognised legal structure, keep down legal costs and appeal to the general public. The importance of the availability of an exit strategy was also highlighted as a major issue, which increased the attraction of the social banks offering deposit accounts.

9.2.4 Responsibilities of trusts and foundations

Charity investors that took part in this study expressed some concern about the role being played by government in promoting social investment. There was disquiet that charitable trusts and foundations are being asked to take disproportionate risk, for example in funding payment-by-results contracts, where government may attempt to shift all risk onto charitable foundations.

Many of the trusts and foundations that we spoke with said that they have deep reservations about payment-by-results contracts in which the principal revenue stream is government contracts. For example, foundations have questioned whether it is ethically acceptable to make a profit out of a social problem such as reoffending. Participants were also worried that the intermediary fees for these deals are a further cost to doing business for the VCSE sector.

Finally, charitable trusts and foundations were feeling some pressure to use their endowments to finance social investment and social enterprises. Given the early

[18] This would include charity bond issues.

stage of development of the social investment market, the dearth of investable opportunities and the difficulty in exiting from investment, they felt that those approaches could damage their capacity to deliver their charitable mission over the long term.

9.3 Guidance on social investment

Most study participants and all charity investors were aware of the Charity Commission's guidance on social investment, *'Charities and investment matters: A guide for trustees (CC14)'*, and it was generally felt to have improved understanding of social investment among charity investors. Awareness among intermediaries was generally high, although higher in England than in Wales, and was broadly welcomed as providing better guidance to charities and giving trustees more confidence in considering social investment: *'It has created a more enabling environment'.*

Participants were asked for their views about both categories of investment discussed in the guidance: programme related investment (PRI) and mixed motive investment (MMI). Their comments focused mainly on the latter.

Although some charity investors had considered MMI and had gone some way through the analysis process, none had categorised any of their investments as mixed motive. Interviewees' views of the guidance on MMI were generally critical, with some exceptions. The language was felt to be confusing and the term 'mixed motive investment' was not found to be in use outside of CC14. Explanations for not using MMI ranged from the requirement for '*a higher burden of proof*' to a view that *'it doesn't exist'.* 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 financial and social return. Another felt that the introduction of MMI *'arguably just confused things'*.

The small number of participants who expressed support for mixed motive investment defined it as using charitable endowments for social investment, rather than substituting social investment for grant-making. The perceived benefit of this approach was that it would allow charitable trusts and foundations to use some of their endowment for programme related investment and to invest larger portions of their endowment for wider charitable aims. A second favourable view of mixed motive investment related to depositing charitable endowment funds in the social banks. This was seen by those concerned as providing social and commercial returns, as well as aligning charities' values with their charitable objectives.

Intermediary organisations raised four issues about the guidance. First, whether charities could make equity investments in private companies, generating surpluses or profits, within the framework of social investment. Second, a need to publicise CC14 to charities, particularly smaller charities and those in Wales and outside London and the South-East. Third, the fact that the guidance in CC14 is the Charity Commission's interpretation of the legal position and does not have the weight of legislation. Fourth, the potential for the Commission to play a role in clarifying for charities that social investment is another way to deliver their mission for public benefit and to maintain charitable funds for charitable purposes.

10. Charities and social investment in the future

In this part of the report, we set out the views of study participants about the future of social investment as it relates to charities in England and Wales. Our findings are presented under four headings:

- Perceptions of the social investment market
- Aspirations for social investment in the future
- Obstacles and barriers
- Success factors.

10.1 Perceptions of the social investment market

Study participants described social investment as *'embryonic'* and at an early stage in its development. Social investment lacks a sufficient *'track record'* to attract interest from the majority of charities, currently, the supply of investment outstrips demand: there is *'a lack of deal flow'.* Most study participants also said that social investment should not be seen as a panacea for the financial needs of all charities or for every social problem. Study participants in charities and some national bodies suggested that non-charitable social investment intermediaries were overly concerned with charity *demand* for investment rather than charity *need* for investment to meet the needs of their beneficiaries. Estimates of social investment demand have been based on projected growth of social enterprise opportunities to supply public services, rather than on charities' need to grow in scale and scope to deliver on their charitable purposes.

Study participants also agreed that social investment is happening in 'pockets' around the country. However, only the charity investees that we spoke to showed awareness of the likely effects of such isolation or how it might need to be addressed. We also heard from most participants about the nascent workforce of advisers in this field; the quality and geographical distribution of advice is variable. Furthermore, the current cohort of highly respected, independent advisers engaged by organisations like Charity Bank is now nearing retirement and a new cohort with comparable knowledge and experience is not being developed.

Finally, study participants identified several links between social investment and wider changes in charity finance and social policy, for example the localism agenda and a growing role for Community Development Finance Institutions (CDFIs). It was suggested that community foundations may be considering social investment because of its links with localism.

10.2 Aspirations for social investment in the future

Although we found a widespread presumption that social investment would have a continuing role in financing charities in future, we also heard widely divergent aspirations for that role. Four main themes emerged from our discussions.

10.2.1 Motivation

When discussing the motivation for engaging with social investment, charitable organisations (investees and investors) talked about helping charities to pursue their mission and strategy for the benefit of beneficiaries, while non-charitable intermediary organisations were more likely to emphasise the potential for scale and replication as part of wider aspirations and expectations for the role and shape of the

VCSE sector. Linked to this, we identified some suspicion and mistrust between some charitable and non-charitable organisations about each other's motivation for engaging in social investment.

10.2.2 A role for wealthy individuals and businesses

A number of study participants wanted further consideration to be given to the potential role, in social investment, of wealthy individuals and businesses as well as trusts and foundations. They felt that the former were underused while the role and contribution of the latter needed to be better understood.

10.2.3 Mixed portfolio of funding

Our findings indicate clearly that charity investees and charity investors want investment to take its place alongside, and not instead of, grants as part of a mixed portfolio of funding where 'blended' finance (combining grants and loans) is an option. Charity investees and charity investors said that grant-making will always be needed for at least two reasons: first, some charities lack the skills and/or capacity to secure and manage investment; and second, some charities focus on issues that are unlikely to generate any form of financial return. These activities are less attractive to investors, so it is likely that they will always need grants to support their work.

10.2.4 Simple investment products

Study participants said that charities need simple investment products. These include what intermediaries call 'plain vanilla' loans (reducing balance, term loans) for most charity needs, simple bond issues[19] for larger, more financially sophisticated organisations, small loans of £5 – 25,000 as well, and patient, evergreen equity finance[20]. Study participants noted that risk capital at low interest rates is necessary for tackling difficult social issues through investment but that this is currently unavailable.

10.2.5 Social investment as an asset class

Some interviewees felt that it was too early or not relevant to talk about social investment becoming an asset class. Others thought that it might be tactically important to *'talk the language of the investor',* but also expressed concerns about whether such a move would *'divide the charity sector'* or affect public opinion about the charity sector:

> *'I want to bring elements of the casino to the social investment market, not bring the social investment market into the casino.'* (Intermediary)

And finally, study participants also commented that it would, in any case, be hard to classify all possible forms of social investment as a single asset class. Other options might need to be considered, they said, such as a class of 'impact investment' with several sub-classes.

[19] Distribution channels for charity bonds are limited, which makes their launch problematic.
[20] Money invested at risk by investors who are willing to extend the term of the investment regularly, to trade financial return for social impact and to wait indefinitely for the return of their capital.

10.3 Obstacles and barriers

Related to their aspirations for the way social investment could develop in the future, study participants raised concerns about how and whether this might be achieved, specifically in relation to policy, impact, transaction costs of small loans and charity regulation.

10.3.1 Policy

Study participants expressed their concern about what might happen if a new government did not favour social investment. Some charitable organisations described the idea that capital investment from trusts and foundations will be complemented by revenue funding from government contracts as *'flawed'*. It was also suggested that the volume of finance available through trusts and foundations will not be sufficient to support the government's ambitions in this respect.

10.3.2 Impact

Little is known about the difference that investment makes to charitable organisations or their beneficiaries, according to our study participants. In particular, they drew attention to the lack of evidence to show that social investment enables organisations to tackle social problems. They identified a number of factors behind this, including: a lack of skills and capacity to assess impact; and a preoccupation with delivering social return or generating the necessary income to deliver a financial return. The following specific points were also made:

- Standardisation of impact measures may obscure benefits to organisations and their beneficiaries. However, they may be helpful for keeping track of financial return.

  'You can't have a standardised form of reporting. It reduced everything to a lowest common denominator. Charities are about human values, hope, renewed sense of self … something like [social return on investment] *can't get at the impact of an organisation. Big Society Capital needs* [impact] *to justify its investment … The impact investing industry that has emerged from America is driving this.'* (Charity investor)

- Intermediary organisations offer charities tailored support through, for example, an annual review. Study participants wanted to see this bespoke approach extended to application and impact assessment processes.

- Public benefit reporting and social accounting can contribute to public confidence, marketing and social impact assessment.

- Decisions about where to invest are influenced mainly by the charity investees' mission, strategy and track record rather than impact measures.

10.3.3 Transaction costs of small loans

It was thought that a small number of large charities will become capitalised either through social investment or because they are already accessing mainstream lending anyway. On the other hand, smaller charities may not be able to access either mainstream or social investment. Study participants drew attention to the high transaction costs of small loans as a challenge facing the charity sector and intermediaries.

10.3.4 Charity regulation

Significance of charity regulation

We found that some non-charitable investment intermediaries that we spoke with did not attach much significance as to whether or not an organisation they invest in was a charity regulated by the Charity Commission. Their focus was more on the introduction of social investment to the broader VCSE sector. As such, they suggested that *'the times have moved ahead of the rules'* and that, specifically, rules about private benefit might need to be re-examined. It was suggested therefore, that while social investment needs *'a range of legal vehicles to accommodate the full range of social investment products'* not all of these *'vehicles'* should be eligible for charitable status. Indeed study participants pointed out that some charities already create trading subsidiaries and form links with organisations that use other legal structures and regulatory frameworks.

Awareness of charity regulation

Although both charity investors and investees were unsure about whether charity law was widely understood by those in intermediary organisations, they were reluctant to see changes to charity law or regulation. As they said: *'changing the charity law framework might stimulate social investment, but it might also call into question what it means to be a charity'.* For example, charitable foundations cannot make an investment with below market rate of return in something outside their mission. Charity investors thought that this was poorly understood by intermediaries.

Public confidence in charities was important to study participants. A small number of participants speculated that if the Financial Services Authority (FSA) became involved in social investment, this might raise public confidence in the market and in charities or other delivery organisations. However, fears were expressed that regulation might slow the growth of the market, particularly while new products and services are being developed.

10.4 Success factors

Study participants identified four key factors that needed to be in place to make social investment work.

10.4.1 Collaboration

Participants highlighted the potential for collaboration between investors (for example, sharing due diligence responsibilities as well as taking up co-investment opportunities) and between investees (for example, peer learning as a means to tackle isolation). It was suggested that other opportunities for collaboration between investors and investees could be provided by formalising and systematising investment products and providing information on those products to potential investees and their advisers. At the moment, each investment decision by each charitable investor is individually tailored which results in higher and unpredictable costs.

10.4.2 Relationships

Participants emphasised the need for relationships and trust between organisations engaged in social investment market development as well as social investment transactions. These relationships could be undermined when organisations did not understand one another's culture, roots or terminology.

10.4.3 Voice

Charity participants asked *'who is leading'* social and impact investment and detected an absence of the charity 'voice' in the market's development. They wanted the kinds of advice and advisers who would 'demystify' social investment, make charities aware of their options and enable them to be strategic in their decision making about investment.

Alongside them, enthusiasm was expressed for the Charity Commission to take a *'responsible tone'* about social investment and *'resist the hype'.*

10.4.4 Communication

Charity investees felt that investors and intermediary organisations need to communicate more clearly the factors they consider in assessing an organisation's investment readiness and their steps in the process of making a social investment. They needed to use language that is familiar to charities or, where that is not possible, to make sure that they provide clear explanations of the terms that they use.

Part Four: Conclusion

This study explored the challenges, risks and opportunities of social investment for charities in England and Wales. We focused primarily on the knowledge and experiences of charities that have received or made investments as well as intermediary organisations engaged in this field. In addition, the study drew on charities' and intermediaries' views about the development of social investment in the future.

We present our conclusions under five headings:

- Charity voice and the significance of charity status
- Simple social investment products and neutral advice
- Collaborative working
- Charities and a successful future social investment market
- Social investment and public trust and confidence in charities.

11. Charity voice and the significance of charity status

Despite increasing policy interest in social investment[21], there is still only a small amount of actual lived experience among charities.[22] Our literature searches indicate that very little has been published about the first-hand experiences of charities either making or receiving investment, while our findings suggest that the significance of charitable status, including the centrality of charity mission, is poorly understood by some of the organisations making social investments currently, particularly those non-charitable intermediary organisations that have entered the market in the past five to 10 years.

Our findings indicate that some intermediary investors do not consider charitable status to be relevant to the way they organise social investment. They show little awareness or understanding of charity regulation and guidance as it affects both investees and investors. For example, there is a lack of awareness that charities are required to report on public benefit, that charitable foundations cannot make an investment with below market rate of return in something outside their mission, and that a charity's mission *must* be linked to their charitable purpose. In this study, participants suggested that if charities were not recognised as a distinct group regulated in a distinct way, then investment processes might not be tailored or appropriate to their needs.

The charity sector appears to be largely absent from conversations about the social investment market, while non-charitable intermediaries have been actively participating in them. Our study findings suggest that there is little movement between the practical experiences of charity investees and the theories and ideas behind the development of the social investment market. Furthermore, in our study, charities (investors and investees) said that contemporary debates about social investment rarely question whether investment is even appropriate for charitable

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[21] Cabinet Office (2011) *Growing the Social Investment Market: A vision and strategy*, London: Cabinet Office; Cabinet Office (July 2012*) Growing the Social Investment Market: Progress Update*.

[22] For commentary on experience in the VCSE, see for example, Joy et al (2011) *Understanding the demand for and support of social finance: Research to inform the Big Society Bank*, London: Nesta.

organisations. Specifically, they suggested that some charitable activities are not marketable and will not attract investment; and that some charities judge that generating a return from work with vulnerable people, such as mental health services users or offenders, is incompatible with their organisation's ethos and values. Although these organisations might be interested in social investment, this was likely to be about purchasing or developing an asset for the benefit of their users.

There was widespread agreement that this lack of understanding about the charity experience may skew the development of the market and associated support because the needs of charities cannot be taken into account. It is possible that charity investors, specifically trusts and foundations, could play a role in addressing these issues.

12. Simple social investment products and neutral advice

We learned from charity investees that their motivation for engaging with social investment generally fell into one of two categories: organisational survival, where a loan or other investment helped the organisation to solve a problem or manage a crisis, and strategic change, where investment was used to achieve a significant shift in the organisation's direction. Many study participants wanted to see intermediaries focussing on ensuring that their social investment products and processes would meet these organisational *needs*, rather than, as is perceived to be the case currently, on generating a *demand* for the social investment products and processes that they provide.

Our research findings suggest, therefore, that most charities need simple social investment products that are presented to them clearly and in accessible language. Many require a simple, standard loan. Study participants mainly agreed that most charity investees do not have the knowledge and experience to select an investment product without advice and they identified a need for neutral advice from organisations that are not social investment market competitors.

However they also said that it is difficult to see who would pay for such advice in the current operating environment of contracting charity infrastructure. Until a charity has actually received social investment, they may not have the resources to pay for independent investment advice and support. Once a loan has been made, the investing organisation receives income which allows them to cover the costs of providing some support. Before the loan is made, the investing organisation is not receiving any revenue, so any support is a cost which may never result in a loan.

Before receiving an investment, charities told us, they benefit from: grants for advice and bespoke support with business planning and gearing up to manage investments; opportunities for peer learning with other charity investees and partnership improvement with charity investors and non-charitable intermediaries.

Our findings suggest that, taken together, these measures might enable charities to choose appropriate and suitable social investment products that offer clear advantages, align with their mission and strategy, can be understood and supported by trustees, and will help the organisation to plan for the long term.

13. Collaborative working

Collaborative working is a familiar theme to the charity sector[23]. Peer learning, in particular, was seen as a cost-effective method for building skills, knowledge and capacity among both investees and investors. Finding ways to share learning and experiences also makes sense in a field where many of the charities receiving social investment are doing so for the first time and investment organisations continue to innovate rather than standardise their products. Collaboration including peer learning among investees and investors as well as intermediaries could, over time lead to standardisation of some investment products and processes. In turn, this could reduce the cost of social investment advice and legal support.

13.1 Collaboration between charity investors

Study participants suggested that social impact assessment might benefit from the collective knowledge and experience of charity investors. The latter were thought to be more familiar than intermediary organisations with the legal and regulatory frameworks within which charity investees operate (including e.g. trustees being required to report annually on public benefit).

13.2 Collaboration between charity investees

Peer learning between charity investees could also connect chief officers and trustees who, our findings suggested, feel isolated and lack opportunities for sharing knowledge and experience. There was a perception that shared learning could also support trustees to make more informed risk assessments when faced with a social investment opportunity.

13.3 Collaboration between charity investors and investees

We found considerable common ground between charity investors and investees in their shared understanding that governance, mission and strategy are essential to successful social investment. Our study also identified roles for trusts and foundations beyond making investments, in particular their potential to link up organisations that are interested in applying for investment with those that have already received investment to look at the lessons that they have learned.

13.4 Collaboration between charitable and non-charitable organisations

Building on our study findings, it is possible that charity investees and investors may benefit from holding discussions with non-charitable investment intermediaries that focus on areas of shared understanding, such as governance and management. Here, there appears to be common ground and there may be greater scope for mutual exchange. In other areas, however, there is less agreement. Opinions varied in relation to impact measurement, for example, where intermediaries' expertise and investees' skills were both questioned.

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[23] See for example Charity Commission (2010) *Strength in Numbers: Small charities' experience of working together*, London: Charity Commission; IVAR (2011) *Thinking about collaboration*, London: IVAR.

Finally, it was thought that trusts and foundations might have a role to play in encouraging and facilitating collaboration. Specifically, they might act as a bridge between intermediaries and potential borrowers in terms of the language and culture of lenders and the language, culture and ethos of borrowers.

14. Charities and a successful future social investment market

Our study participants identified four features of a successful social investment market from the perspective of charities. They are:

- Collaboration between charity investors (e.g. co-investment and shared due diligence) and charity investees (e.g. peer learning to tackle isolation of chief officers and trustees).
- Trust between organisations engaged in market development through better understanding of each other's culture, roots and terminology. A shared approach to impact measurement would also be helpful.
- Clear communication in simple language about social investment products and processes to demystify them and to enable charities to be strategic in their decision-making about social investment options.
- Awareness of appropriate organisational forms and legal structures for social investment; understanding of the boundaries of charitable status.

15. Social investment and public trust and confidence in charities

This study has drawn attention to the issue of public trust and confidence in charities, and how the growing social investment market may affect this. Charity participants in the research felt public confidence was important and that proper regulation is required to reassure the public. Ethical issues were raised about whether social investment runs counter to the 'ethos' of charity, particularly in relation to the distribution of financial profits as a result of tackling a social problem.

We know from the literature[24] that we reviewed as well as our own study findings that some charities received social investment through their subsidiary organisation and some of those subsidiary organisations were community interest companies (CIC) or companies limited by guarantee. We found that charity investees and investors perceived as relevant, therefore, the role of the CIC regulator and Financial Services Authority, as well as the role of the Charity Commission. This was linked to their commitment to maintaining public trust and confidence in the charity 'brand'.

In conclusion, we have learned that, first, social investment decisions, processes and management appear to benefit from attention to governance, mission and objects and charity regulation including public benefit requirements. Second, if these are clearly articulated and accompanied by business planning advice and support, they may provide a framework for charities to be strategic in their decision-making about social investment. Finally, it would be helpful, therefore, for non-charitable intermediaries to understand this framework, and for charity investors to lead the process of learning and sharing knowledge between charity investors and investees and charity and non-charitable intermediaries.

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[24] See for example *Regulator of Community Interest Companies Annual Report,* 2011-2012; and NCVO (2012) *The UK Civil Society Almanac*, London: NCVO.

Appendix One: Study participants

We have listed below the national bodies and institutions that we interviewed for the study as well as the members of our study reference group. We do not name the individual 25 charity investees and 25 charity investors that contributed to the study through interviews and group discussions.

Organisations and national bodies interviewed

- Association of Charitable Foundations
- Big Issue Invest
- Big Society Capital
- Charity Bank
- Charity Bank Wales
- Charity Finance Group
- City of London Corporation
- Community Interest Company Regulator
- Financial Services Authority
- Investing for Good
- Locality
- National Council for Voluntary Organisations
- NESTA
- New Philanthropy Capital
- RBS Nat West
- Social Finance
- Social Impact Investors group
- Social Investment Business
- University of Birmingham
- Wales Council for Voluntary Action

Reference group

- Joanna Holmes, Barton Hill Settlement
- Ben Hughes, Community Development Finance Association
- Andrew Robinson, CCLA
- Simon Steedon, Bates Wells & Braithwaite
- Brian Whittaker, LankellyChase Foundation

Appendix Two: Approach and methods

We knew from the outset that there is a wide variety of opinion and perception about social investment and a range of knowledge and experience among charity investees and investors. As such, we designed the study to elicit opinions and perceptions as well as knowledge and experience. This report is based on interviews, meetings and facilitated group discussions with:

- 20 intermediary, infrastructure and academic/think tank organisations
- 25 charities that have received social investment across Wales, the South East of England, Yorkshire and the Humber regions
- 25 charities that have made social investments.

We used a purposive sampling method to select study participants based, initially, on our knowledge of the field and the interests of the Charity Commission. As the study progressed, we revised and added to our sample to ensure that a wide variety of knowledge and experience, opinion and perception could be collected.

Our analysis of the data we have collected is intended to illuminate and understand those differences rather than reconcile them. Given that this is a qualitative rather than a quantitative study, we do not indicate the number of people holding any specific point of view; rather, the findings present the range of ideas expressed, although we do highlight points made by several interviewees.

To avoid repetition we have produced a synthesis of those opinions and experiences where they are alike. Where they differ we indicate whether they come from charity investees, charity investors or intermediary or infrastructure organisations. We shared and discussed our analysis and conclusions at two stages: after a preliminary analysis we discussed emerging themes with the reference group and the Charity Commission. Following further analysis and refinement, we shared and discussed the final conclusions at a specially convened symposium.

We do not attribute comments to the individuals or organisations that took part in this study. In Appendix One we list the intermediary, infrastructure and academic/think tank organisations that took part. We do not name the charity investees and charity investors that participated. However, for context we do provide here a profile of charity investees that participated in the study.

Profile of charity investees that took part in the study

We spoke with chief officers, trustees and senior managers in 25 small and medium sized charities, most of which operate across a single district or region. Four operated nationally. Virtually all of the organisations are both registered charities and companies limited by guarantee. Five have additional trading subsidiaries that are not registered charities. The organisations are engaged in: sports/recreation and arts facilities, care and support or education services, community hub, and explicitly economic activities related to employment and/or financial inclusion. They operate shops and fee charging services, typically venue hire.

All but one of these organisations had received their first or only investment since 2002 with one loan made in the 1990s. The value of the investments ranged from £15,000 to £4m with half of all investments under £100,000. The majority were capital investments in the form of property, equipment and refurbishment, but four organisations had secured investment to support the implementation of a new organisational or service delivery strategy, and three organisations had secured investment for core staffing costs and/or cash flow.

Profile of charity investors that took part

We met with members of the Social Impact Investors Group and with other chief officers, senior staff and trustees of trusts and foundations operating in England and Wales. In terms of investment, these ranged from between £1.5m and just over £20m per trust, with the proportion of endowments committed to social investment ranging from 2.5% to 40%[25] of total endowments. A wide range of investment types have been used, including direct and intermediary investments, equity, quasi-equity, secured and unsecured loans. Investment sizes range from £20,000 to £1m. Total investments were estimated to amount to less than £50m.

[25] The larger proportions tend to apply to very small trusts.

Appendix Three: Glossary of key terms

Annual review	Yearly review of borrower's financial and organisational performance by lender or investor
Asset	A tangible or intangible resource that can be owned or controlled to produce positive economic or social value
Asset class	Types of assets, such as equities, bonds and cash that share similar risk and return investment characteristics
Bequest	Property given by a deceased person by will
Blended finance	The provision of finance through a combination of grants and/or equity/quasi-equity finance and/or debt finance
Business case	A structured proposal analysing the costs and risks of initiating a project or task
Business planning	The process of producing a formal document that sets out business goals and the plan for attaining them
Capital investment	Investing money in capital or fixed assets
CC14	CC14-*Charities and Investment Matters: A guide for trustees* Charity Commission guidance for trustees on how to make decisions about investing charity funds
Charitable objects / purposes	A charitable object or purpose is one that: • falls within the descriptions of purposes in the Charities Act 2011 and • is for the public benefit
Charitable status	In England and Wales, an organisation has charitable status if it is: • set up under the law of England and Wales • subject to the courts' charity law jurisdiction • established for charitable purposes only
Charitable trusts	Strictly speaking, a charitable trust is a charity governed by a trust deed. The term is commonly used to describe charities that provide grants and other support to individuals or other organisations
Charitable foundation	The word foundation has no strict legal meaning in England and Wales but is usually used to mean a charity that provides grants or other support to other organisations
Charity Commission	The Charity Commission is an independent, non-ministerial government department that registers and regulates charities in England and Wales
Charity governance	The processes and activities involved in making sure a charity is effectively and properly run
Charity investee	A charity that has received social investment
Charity investor	A charitable organisation that makes investments of any kind
Charity regulation	Charity regulation is the process of overseeing and enforcing trustees' compliance with their duties in governing their charity. Most charities in England and Wales are regulated by the Charity Commission. Some types of charity are exempt from regulation by the Commission, usually because they have another Principal Regulator (charity regulator). Charities in Scotland are regulated by the Office of the Scottish Charity Regulator (OSCR). Charities in Northern Ireland are regulated by the Charity Commission for Northern Ireland (CCNI)
Community asset transfer	The transfer of land and buildings from public bodies to

	voluntary, community and social enterprise organisations
Community Development Finance Institution (CDFI)	CDFIs provide financial services to businesses, civil society organisations and individuals who are unable to access mainstream financial services
Community interest company	Limited company created for the use of people who want to conduct a business or other activity for community benefit and not purely for private advantage
Company limited by guarantee	Limited companies that do not usually have share capital but have members who act as guarantors for a nominal sum. They are used by charities, community projects, clubs, societies and social enterprises
Cooperative	An association of people who cooperate for their mutual, social, economic and cultural benefit
Deal flow	The rate at which investors and lenders receive business proposals
Donation	A gift, typically for charitable purposes
Due diligence	The processes of investigation of a business or person before investing in or lending to that entity
Endowment	The property of a charity (including land, buildings, cash or investments) which is required to be invested or kept and used for the charity's purposes. Whether it can be spent or disposed of depends on the conditions under which the endowment was originally given
Equity	The value of an ownership interest in property, including shareholders' equity in business
Equity investment / finance	Investment to purchase a share in a business
Ethical investment	Investments screened to exclude investments that would be harmful to the investor's aims or beneficiaries, or unacceptable to its supporters
Exit strategy	A strategy to withdraw an investment
Financial analysis	Assessment of the financial viability, stability and profitability of an organisation or project
Financial inclusion	Ensuring that everyone in society is able to access and use appropriate and affordable financial goods and services
Financial projections	Detailed statement of expected financial outcomes for an organisation or project
Financial risk	Multiple types of risk associated with financing including the risk of a borrower not making repayments as promised
Financial Services Authority (FSA)	Responsible for the regulation of the financial services industry in the UK until April 2013, when it will be replaced by the Prudential Regulatory Authority and the Financial Conduct Authority
Fixed interest bond	A financial product where the bond issuer owes the bond holder a debt and is obliged to pay them a fixed rate of interest at set periods and to repay the debt in full at the end of the bond period or maturity date
Grant	An award of money usually made by government, business or a charitable trust and often with restrictions
Illiquid investment	An investment which is difficult to sell and convert to money
Impact	The changes an investment or organisation achieves; the difference it makes
Impact assessment	A process of gathering and analysing information and making a judgement about impact
Impact indicator/measure	A way of quantifying the impact of an activity

Impact investment	Investment made with the expectation of delivering measurable social and/or environmental impact as well as financial return
Impact investment sub-class	Sub-categories within the proposed impact investment class which might class together investments in particular markets such as microfinance or particular types of investment such as fixed income or equity investments
Impact targeting	Using impact information to target investment and activity
Infrastructure organisation	Organisation that exists to support voluntary, community or social enterprise organisations in achieving their aims
Intermediary organisation	An organisation that connects those with funds to invest and those seeking investment
Investment advisers	Individuals or firms authorised by the relevant regulatory body to provide investment advice
Investment barriers	Obstacles to making or receiving investment
Investment products	Products including shares and bonds that are bought with the expectation that they will produce a financial return
Investment readiness	The level of preparedness of an organisational or business investment proposal to attract and manage investment. The extent to which investment readiness can be demonstrated depends on the robustness of the business model, the strength of governance, the level of planned social impact and the effectiveness of the management team
Loan	An amount of money supplied by a lender to a borrower with an agreed repayment schedule and, in most cases, a cost in terms of interest charged on the loan
Logic model	A tool used by managers and evaluators of projects to connect inputs, activities, outputs and outcomes
Market analysis	A study of the competitive factors at play in a particular market, in order to inform business strategies
Mission	An informal description of what an organisation exists to do
Mixed Motive Investment	An investment that cannot be justified as wholly furthering a charity's aims or seeking the best possible financial return. Trustees may be able to invest in this way if they are satisfied that it would be in the interests of their charity
Mixed portfolio of funding	A range of income streams which may include grants, donations, earned and investment income
Patient risk-capital	Money invested at risk by investors who are willing to trade financial return for social impact and to wait longer for the return of their capital
Payment by Results	A type of public policy instrument where payments are based on independent evaluation of results
Peterborough Social Impact Bond	First pilot, launched in 2010, of a payment by results approach between the Department of Justice and Social Finance UK, where investor funds are used to pay for intensive activity with short term prisoners in Peterborough to reduce recidivism
Plain vanilla debt finance	The simplest form of loan without any optional extras
Pro bono support	Support provided voluntarily and without payment 'for the public good'
Programme Related Investment	Using assets to directly further the charity's aims whilst potentially also generating a financial return

Public benefit	The legal requirement that every organisation set up for charitable objects/purposes must demonstrate that there is an identifiable benefit or benefits and that the benefit must be to the public or a section of the public
Public benefit reporting	Charity trustees have a duty to report regularly in their Trustees' Annual Report on how they are carrying out their charity's objects for the public benefit
Quality revenue stream	Income, from an identified source, that is timely, reliable, steady and with potential to grow over time
Quasi-equity	Provides finance like equity investment for organisations such as charities that cannot offer shares. Investment is usually structured so that the return to the investor is based on growth in income streams
Revenue funding	Income received to pay for an organisation's running costs
Revenue stream	Different categories of income such as grant funding, earned or investment income
Risk assessment	Formal process to identify and measure risk
Risk capital	Equity or quasi-equity investment which is most at risk in recovering an investment if the project or organisation fails
Risk mitigation	Taking action to reduce or manage identified risk
Secondary market	A market in which investors can buy and sell financial assets among themselves rather than from the issuing charities and social enterprises
Secured loan	A loan in which the borrower pledges some asset such as land or a property as collateral for the loan, which can be sold to secure repayment of the loan if the borrower defaults
Skills audit	The process of identifying what skills and knowledge an organisation's board needs in order to run the organisation well, and finding out whether the board currently has them
Social accounting	Process of identifying and communicating the social and environmental impacts of an organisation's activities to its stakeholders
Social impact	The effect of an activity on individuals, groups and communities
Social Impact Investors Group	Charitable trusts and foundations group that works together to catalyse social investment in the UK
Social investment	Investment that produces a social as well as a financial return
Social investment intermediaries	Organisations that connect those with funds to invest and those seeking social investment
Social return on investment (SROI)	A principles-based method for measuring environmental and social value
Social Stock Exchange	New organisation which aims to provide a forum for social enterprises and social purpose businesses who wish to raise risk capital and social impact investors who wish to invest in such organisations
Subsidiary organisation	An organisation which is owned and/or controlled by another. Some charities have set up trading subsidiaries to earn income
Syndicated deals	A loan or investment offered by a group of investors called a syndicate, who work together to provide funds for a single borrower
Theory of change	A planning and evaluation tool that maps the relationship between inputs, outputs, outcomes and impact

Trading subsidiary	A trading subsidiary is a company, owned and controlled by one or more charities, set up in order to trade. The purpose of a trading subsidiary is usually to generate income for its parent charity
Transaction costs	The costs of making a social investment including legal costs and the costs of carrying out due diligence assessment of the investment proposal
Trustee	Charity trustees are the people who serve on the governing body of a charity. They may be known as trustees, directors, board members, governors or committee members. Charity trustees are responsible for the general control and management of the administration of a charity
Unsecured loan	A loan that is not supported by a lien or charge on specific assets of the borrower in case s/he fails to repay