Growing the Social Investment Market: A vision and strategy

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Ministerial foreword

We want a bigger, stronger society. One where communities and citizens have more power to shape their lives and determine their destinies. This is about so much more than just encouraging the voluntary sector to grow; to really see change we need to accompany this with localising swathes of power and opening up public services.

Pushing power away from the centre to local government, and beyond local government into the hands of neighbourhoods and citizens, will help to catalyse local social action. The NHS and school reforms, locally elected police and crime commissioners, open-source planning controls, and our Community Organiser programme are all part of this.

As part of our public service reform, we will break up public sector monopoly suppliers, encourage a wider diversity of providers, and give more choice and control to service users. The Work Programme, with Payment by Results, and our support for groups of public service workers to form co-operatives to spin out of the public sector illustrate this commitment.

We want social ventures to take full advantage of these opportunities and create positive change in our society. To achieve this, we need to make it easier for them to access the capital and advice they need.

There is a growing social investment market which is prepared to blend financial return with social impact. However, it is embryonic and needs support.

We are determined to accelerate the growth of this market. This document sets out our vision for using social investment to improve our society, and a strategy for how we can achieve that goal together. With added support from the largest UK banks, we are on the brink of realising the vision for the *Big Society Bank*. We believe that it will be an important catalyst for growing the amount of private capital available to support our social entrepreneurs.

This is not about handouts – it is about encouraging a new, self-sustaining market to grow, free of state interference. We want more social investment opportunities to be available to citizens and the managers of our savings. In the same way that finance flowing to business start-ups is the lifeblood of our economy, so it will be with social enterprises. Change in this market will not take place overnight, but it will be transformative in allowing social ventures to scale up and take on new challenges. We will do all we can to make it happen.

Rt Hon Francis Maude MP
Minister for the Cabinet Office
and Paymaster General

Nick Hurd MP
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Introduction and executive summary

Britain is blessed with inspiring social entrepreneurs driven by a desire to improve the lives of their fellow citizens. They lead organisations bent on finding sustainable solutions for entrenched social problems. These organisations are social ventures – and it's time to get behind them. We need their innovative approaches if we are to build a bigger, stronger society. We need their involvement to open up and decentralise our public services. But to do more, social ventures need easier access to capital. They need capital just as businesses do – to finance their expansion and build their resilience. **Chapter 1 outlines what social ventures are and why they need better finance.**

So our vision is to create nothing less than a long-term 'third pillar' of finance for our crucial social ventures, alongside traditional giving and funds from the state. This pillar of finance is social investment, money that blends financial return with social return. Our vision could eventually see individuals and families choose some social investments as part of their ISAs or pension fund. And it could help unlock a slice of the £95 billion of UK charitable income and endowment assets for social investment. **Chapter 2 sets out our vision for the social investment market.**

There is an embryonic market providing some of this capital. It has grown from almost nothing over the past 10 years, and in 2010 made nearly £200 million of social investments. But this is still way below its potential scale, and it is held back by some important barriers. **Chapter 3 shows where the market has come from and where it is today, and also the symptoms and causes of its embryonic state.**

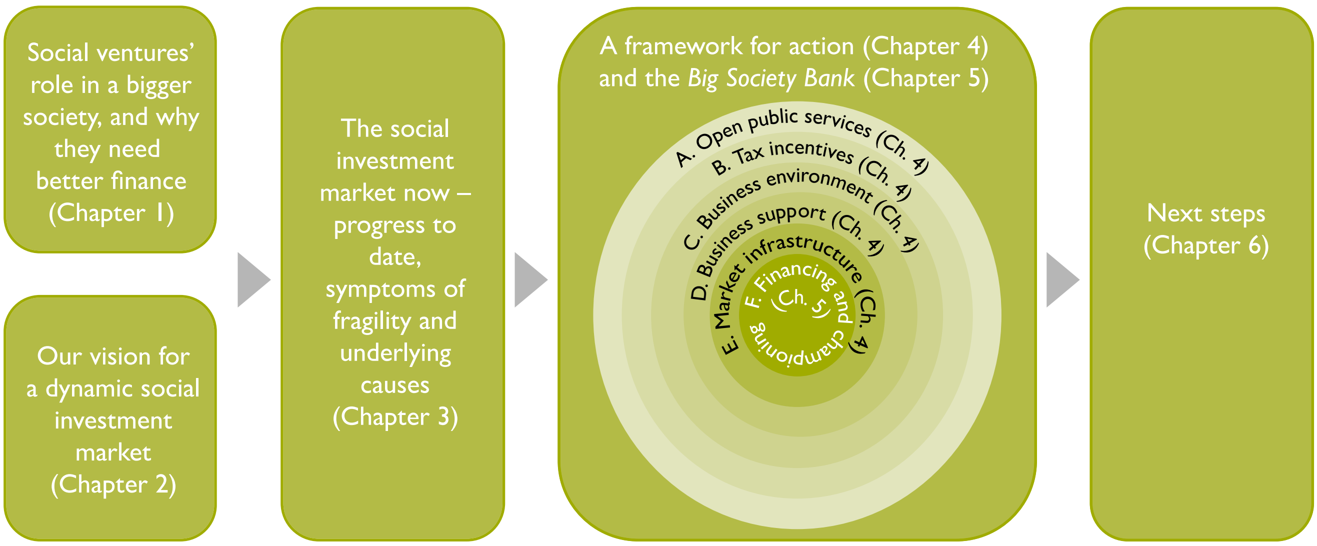
We think it is in the national interest to accelerate the growth of social investment. This strategy sets out the actions we think will do this.

We need a better enabling environment for social investment. The Government's plans to open up and decentralise public services offer new opportunities for social ventures to deliver public contracts and to help people purchase community assets. We can review the effectiveness of both the tax incentives that encourage a blend of social and financial return, and the regulatory and legal framework for social investment. Draft Charity Commission guidance provides greater clarity on seeking a social return on charitable investments. We can do more to help those building the infrastructure of the market, such as better ways of measuring social return, and make it easier for social ventures to find the support they need to become 'investment ready'. **Chapter 4 outlines the enabling actions that will allow social investment to flourish.**

But enablement alone is not enough to turbo-charge social investment growth. The need for a social investment bank has been talked about for 10 years: the Coalition Government is on the brink of realising the vision for it. The *Big Society Bank* will play a critical role in leveraging in new finance and speeding the growth of the market. But the *Bank* will also catalyse advice and assistance, and act as a vital portal to connect front-line social ventures with sources of investment. Ultimately it will help social ventures to do more to build a stronger society. **Chapter 5 sets out the mission and role of the independent, wholesale *Big Society Bank*.** We will now work with leading social investment experts to develop a proposal for the establishment of the *Big Society Bank* as an independent, private sector organisation. We are on track to see some of the *Bank's* functions in place by April 2011. The *Bank* will be capitalised with a £200 million injection from the largest UK banks. It will also be capitalised from dormant accounts and we estimate that the first year's release in 2011 will be in the region of £60–100 million, with the total value of dormant accounts being around £400 million. We expect to be able to make the first investments using dormant account money from mid-2011.

While government has a major role to play, development of the social investment market will be a collaborative effort. Social ventures that want to benefit will have to become investment ready. Existing specialist intermediaries will have to step up to the challenge of developing their profiles and their product ranges. We want to see new social finance intermediaries enter the market, not least mainstream financial institutions that can see the potential to develop a new 'asset class'. Investment advisers such as wealth and pension fund managers must seriously consider social investment products as and when they emerge. Large-scale investors such as philanthropic foundations and 'high net worth' individuals can start to see social investment as a core proposition in their portfolios and not just as a marginal product. And ultimately it is the millions of socially responsible savers in this country, sitting on trillions of pounds of assets, who can take this market to full maturity as they grasp the chance to make a positive social contribution through their personal finance choices. **Chapter 6 sets out the next steps for government and the role we hope others will play.**

Fig. 1: A strategy to develop the social investment market



Chapter 1
Social ventures' role in a bigger society, and why they need better finance

Social ventures are diverse – but share a passion for finding innovative solutions to social problems

1.1 Britain needs new ways of tackling some very stubborn and expensive problems such as fractured communities, homelessness and high rates of re-offending.

1.2 Social entrepreneurs and the social ventures[1] they lead bring innovative solutions by combining social mission with sustainable business models. Our social ventures can do amazing things, as illustrated in the boxed examples – whether helping to support the most vulnerable and disadvantaged, providing employment in marginalised communities, or improving the environment. Not everyone can run a school or set up a library from scratch, but social ventures provide real ways for interested citizens and communities to get involved in tackling inequality and building a better society.

1.3 Social ventures are defined by what they do: generating social value in a way that is financially self-sustaining. And they are prepared to access external investment to maintain and scale their impact. They range from small charitable and community start-ups right through to the largest and longest-established social enterprises. They span a variety of market sectors, business models and legal structures.

1.4 Social ventures can include:

- **community organisations** – mission-driven organisations such as Highercroft Action Group (refer to box) that offer services to a specific community or area and aim to build community cohesion and social capital;

Highercroft Action Group is a Lancashire-based community organisation that was set up in 2008 to improve the lives of young people and promote community cohesion on the local Roman Road estate. It started with the transfer from the local council to the community group of two local assets that had fallen into disrepair and disuse – a multi-use games area and a recreational games park. Highercroft Action Group raised funds to regenerate and rebuild these assets, hosting community cohesion events at the new sites (such as a local carnival, youth club, football tournament and junior masterchef competition) and providing volunteering opportunities to young people in the community to help to manage the new assets.

The community organisation established a foundation to help to raise funds (£100,000 to date, mainly from local support services and BIG Lottery funding).

- **charities** – organisations such as Shelter (refer to box below) with a regulated charitable status that defines their social purpose and blocks them from distributing profits. Charities can take on a number of social venture business models, although many rely on grant or donation income as the traditional vehicle for creating social or environmental benefit;

> **Shelter** is a charity that works to alleviate the distress caused by homelessness and bad housing. It develops practical solutions by giving advice, information and advocacy to people in housing need. It also engages in campaigning and works with the housing sector to promote good practice.
>
> Shelter generates most of its revenue from voluntary income (51% of income), national and local government grants (31%) and through its commercial activities (15%) in approximately 100 Shelter shops, training services and housing publications.

- **social enterprises** – businesses such as Bikeworks (refer to box) with primarily social objectives and whose surpluses are principally reinvested for that purpose in the business or community, rather than being mainly driven by maximising profit for shareholders and owners; and

> **Bikeworks** was set up in 2007 with the aim of using bikes to tackle environmental, social and economic challenges in Tower Hamlets, east London. Bikeworks provides employment and training opportunities for marginalised individuals in recycling and refurbishing second-hand bikes. Bikeworks' approach is to develop and build on the best of small-scale community cycling initiatives but to do so on a greater scale, achieve significant outcomes and build a viable replicable model. They recently opened a second community cycling hub in Kensington and Chelsea, west London, in September 2010, and have aspirations to replicate the service further.
>
> Bikeworks' income is earned through contracts to provide a range of organisational cycling services to local authorities, civil society organisations and corporate clients. It also generates income from the retail sale of recycled bikes and the provision of repairs and maintenance services to the public.

- **social firms** – a sub-set of mainstream enterprises that use market-led businesses to employ people who have a disability or are otherwise disadvantaged in the labour market. CLARITY is an example (refer to box opposite).

CLARITY employs over 60 people who work in the manufacture and sale of soap, hand washes, toiletries, cleaning products and perfumes for both UK and export contract customers. It also produces its own CLARITY brand products. Currently, 61% of CLARITY's employees are blind or have a disability, and they work in a range of factory and office positions throughout the UK. CLARITY also runs specialist 'Skills for Life' training programmes, National Vocational Qualifications and basic literacy, numeracy and IT courses to support employees to progress in the organisation and ultimately into mainstream industry.

CLARITY has a turnover of almost £4 million. The majority of its income is earned through trading, with a proportion earned through government contracts for supported employment provision. All of its profits are re-invested in the organisation to provide training and employment opportunities for blind people.

1.5 So, social ventures span a diverse range of organisations. But what unites them all is a passion for improving society.

Social ventures' ability to combine social value with financial stability is key to building a bigger, stronger society

1.6 The power of social ventures is central to creating a bigger, stronger society – a Big Society – because they help to:

- **empower communities** to take control, for example by owning and running their local amenities. For instance, the Shelley Community Association[2] in Yorkshire has created a village hall that runs local activities and ensures that there is a local post office service for the community;

- **open up public services**, through national and local government contracting with social ventures in ways that involve citizens in service shaping and delivery. For instance, London Early Years Foundation[3] is London's largest childcare charity and social enterprise, operating a socially inclusive fee structure where parents pay what they can afford. This ensures that all children, regardless of their background, have access to quality care and a broader experience. And large national social enterprises such as Turning Point[4] can provide specialist and integrated drug rehabilitation services. These are examples of the innovative delivery models that public service commissioners increasingly must consider as they work to meet the overall needs of individuals rather than just deliver a series of disconnected activities; and

- **provide a stronger conduit for social action** and bringing people together, for example by helping citizens to donate their own time and expertise towards achieving social outcomes. For instance, Spice[5] has developed community credits that enable people who contribute to their community and public services to redeem them for a variety of recreational activities.

1.7 Social ventures are also making a big contribution to economic growth in what remains a challenging economic and fiscal environment, and can play an important role in helping to re-balance the economy. Already their economic impact includes:

- a £24 billion annual contribution to the **economy**[6] – equivalent to 1.5% of GDP – based on the formal definition of social enterprise used in the Small Business Survey by the Department for Business, Innovation and Skills (BIS);

- making a positive contribution to **employment.** Social enterprises alone employ at least 800,000 people,[7] and support the labour market by operating in disadvantaged areas and offering employment opportunities to traditionally excluded groups. For instance, Create[8] is a social enterprise in Leeds providing innovative training and employment opportunities for people who have been homeless, marginalised or vulnerable. Its diverse businesses include outside catering, retail and its own café; and

- **building new markets** by responding to consumer demand for new ethical products. For instance, Global Ethics' One Water[9] is an ethical bottled water brand where 100% of the profits go into funding 'play pump' water systems in Sub-Saharan Africa.

Social ventures could do even more – if they had better access to finance

1.8 Britain is fortunate to have social ventures led by people prepared to take a risk as they find better ways of improving others' lives. But we recognise that social ventures operate in a tough environment, and are often held back by bureaucracy and an inefficient financing market.

1.9 So, we want to set social ventures free to succeed and grow further. We are already taking steps to do this, including:

- **opening up the provision of public services to a wide range of new providers.** The *Modernising Commissioning*[10] Green Paper published in December 2010 included measures to level the playing field for social ventures competing for government contracts. The forthcoming White Paper on open public services will announce further details;
- **making it easier to set up and run civil society organisations.** The Cutting Red Tape taskforce, led by Lord Hodgson, is looking at reducing the bureaucratic burden on small organisations within the civil society sector. We are also looking to reform the planning system as detailed in the *Local Growth*[11] White Paper in October 2010; and
- **increasing social ventures' access to people, time and money**, as set out in the *Giving*[12] Green Paper in December 2010.

1.10 But lack of access to capital is still holding social ventures back. It can frustrate investment in key areas such as buildings, equipment, technology and staff training. New social ventures struggle to get going without start-up capital. Social ventures already trading find it difficult to cope with 'lumpy' cash flow without working capital. And we have only a few social ventures that operate on a large scale. This is partly because of a lack of capital for growth: without it, a social venture that is ready to grow or replicate cannot invest in the facilities it needs to generate new streams of income.

1.11 The picture could be very different. Capital on the right terms, combined with support and advice to put it to work efficiently, can help social ventures to:

- **better manage cash flow** and improve financial resilience. For example, suitable working capital can help social ventures to deliver Payment by Results contracts as part of the growth of alternative public service delivery models;
- **invest in equipment and facilities** to make the most efficient use of limited resources such as volunteer time;[13] and
- **grow or replicate** to increase the scope of their activities, reach more people in more geographical locations, and generate greater income.

1.12 The key to better capitalised social ventures, and therefore greater social value, is more and better social investment. Investment that is for the long term, helping to tackle entrenched social challenges through preventative action. Investment that no longer presents a stark choice between financial return and outright giving. Investment that can help many social ventures, because repaid money can be used again and again. So in this strategy we are setting out our vision for a bigger social investment market, including the prospect of a *Big Society Bank*.

Chapter 2
Our vision for a dynamic social investment market

Our vision is to create nothing less than a new pillar of finance for social ventures …

2.1 We want to make it easier for social ventures to access the capital and advice they need to grow, unlocking the potential to improve more lives. So at the heart of our vision is nothing less than a new 'third pillar' of finance for social ventures, to sit alongside traditional giving and funds from the state.

2.2 This new pillar of finance demands a greater role for investors, both institutions and individuals. The history of mainstream institutional involvement in existing social markets – such as housing associations, microfinance and landfill – shows that money can be attracted where there are simple business models and effective management. And we believe that, over time, individual investors will be receptive to simple retail products from credible suppliers that give them a chance to 'invest for good', as long as they believe there is a reasonable chance of getting their money back, possibly with a positive financial return. Our vision calls for the creation of a new 'asset class' of social investment to connect social ventures with mainstream capital.

2.3 We do not underestimate the degree of challenge, or the timescale required to realise our vision. But the opportunity is large. UK charitable investment and endowment assets alone account for nearly £95 billion.[1] If just 5% of these assets, 0.5% of institutionally managed assets and 5% of retail investments in UK ISAs were attracted to social investment, that would unlock around £10 billion of new finance capacity.[2]

… allowing social ventures to grow more dynamically …

2.4 Finance on this scale will have a transformative effect across social ventures, their users and customers.

2.5 For **individual social ventures**, our vision will mean that they:

- have access to a larger pool of social investment as well as more investment readiness support; and
- can access investment products tailored to all stages of growth and replication, from 'angel' financing for start-ups, to venture and equity-like financing for growth, to structured investment products and retail banking for large-scale working and investment capital finance.

2.6 For **the social venture sector as a whole**, our vision could see a big expansion in its size and dynamism, with the concept of businesses that produce social as well as financial return becoming mainstream. It could see:

- more, faster-growing social ventures, creating greater social value for their users and customers, and making a greater contribution to the economy; and
- greater dynamism in the sector, with higher 'churn' – more new entrants to the market and more frequent changes among the 'leader board' of the most successful social ventures.

2.7 For **other voluntary, community and social enterprise (VCSE) organisations**, our vision offers opportunity. Our intention is neither to privatise the social sector nor to bring it into the public sector. Social investment is not a panacea. We recognise that some VCSE organisations may prefer not to seek financing of this type. However, we believe that many VCSE organisations *will* want to consider social investment as a potentially useful tool to help them increase the scope, reach and longer-term sustainability of their activities.

… allowing individual citizens to contribute to social goals through their personal finance choices …

2.8 For **individual citizens**, our vision will open up new opportunities to make social investments that complement rather than replace outright giving. This might mean the emergence of ISAs or pension funds with a social return element. In addition, we would expect many more opportunities for people to invest in their local communities, such as taking a share in the ownership of their local pub, shop or post office. We see greater choice in personal finance as another way in which individuals can contribute to the Big Society.

… and offering new opportunities to investors, financial institutions and wider government

2.9 For **charitable foundations**, our vision will open up new opportunities to unlock their reserves of capital for social investment, investing with confidence on the basis of both clearer Charity Commission guidance and a developing investment track record from the market.

2.10 For **'high net worth' individuals and philanthropists**, our vision will see increasing access to a 'third pot' for their assets, separate from purely commercial investment and complementary to charitable giving.

2.11 For **mainstream banking institutions**, our vision is an opportunity to accelerate the growth of the social investment market by dedicating resources to originate, structure and distribute a new class of investment products. As the market matures, and the supply of bankable and investable social ventures and social venture intermediaries increases, we envisage banks allocating greater amounts of their capital and lending capacity to social investment, comfortable in the knowledge that they can do so in a prudent and commercial manner.

2.12 For **other financial services firms and intermediaries**, such as traditional investment managers, advisers and pension funds, our vision will see them being prepared to invest a greater proportion of their assets and their clients' assets in social investments, while building the resources and expertise necessary to research and evaluate the opportunities presented by this new class of assets. We envisage them developing a range of new products which will open up the social investment opportunity to a broader and better informed investor community.

2.13 For **central government departments, local authorities and the wider public sector**, our vision will bring new opportunities for better procurement of goods and public services. And it will provide new options for local authorities working to support the economy and micro-enterprise locally – through their commissioning choices, and potentially even through their own social investments.

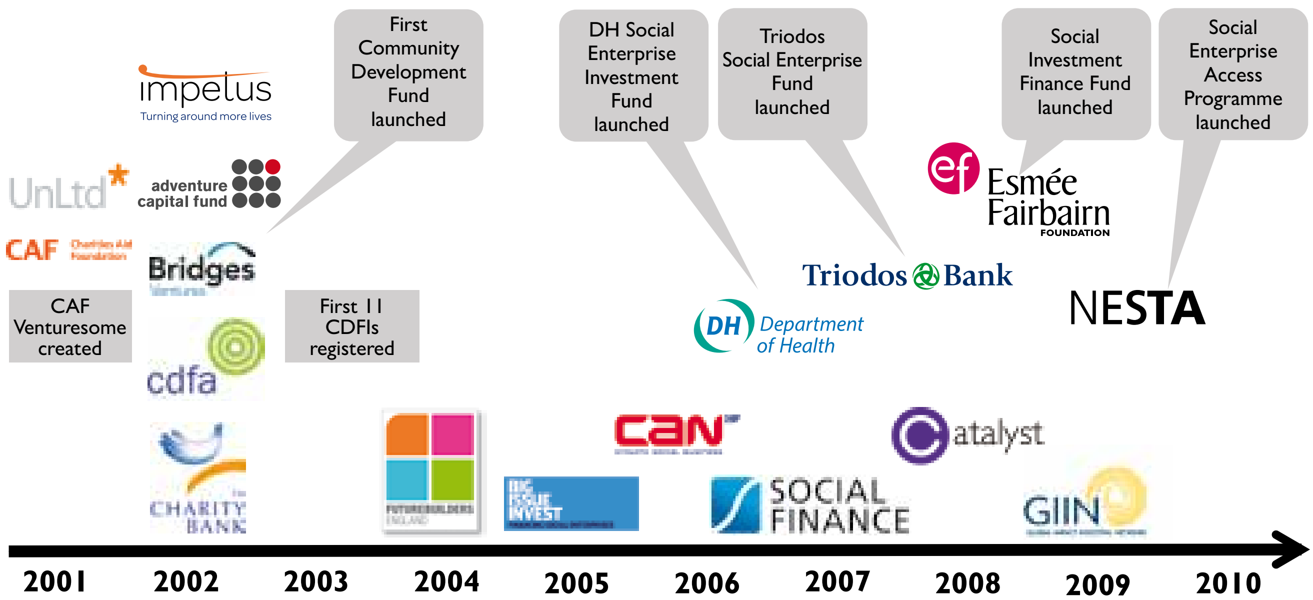
2.14 So, our vision is one that could dramatically alter the way we tackle social issues, as well as make a significant contribution to a more balanced economy. In the following chapters of this strategy, we show what the social investment market looks like now, and what actions could help it to grow and make this vision a reality.

Chapter 3
The social investment market now – progress to date, symptoms of fragility and underlying causes

Our vision for social investment is bold, but we are not starting from scratch

3.1 We acknowledge that our vision for a thriving social investment market, outlined in Chapter 2, is ambitious. But we are certainly not starting from scratch. The market has developed enormously over the last decade, as shown in Figure 3.1.

Fig. 3.1: Timeline for the emergence of social venture intermediaries that provide finance[1]



3.2 There have been many individual examples of successful social investment – such as KIDS, East Lancs Moneyline and Alt Valley Community Trust (refer to boxes). More generally, the development of the market is reflected in:

- increasing investor interest;
- the emergence of social venture intermediaries; and
- the development of new types of financial products.

Since it was established over 40 years ago by teacher John Mulcahy to provide holidays for disabled children, **KIDS** has become a leading provider of respite services and inclusive nurseries. The charity now helps thousands of disabled children and their families each year.

In October 2007, KIDS received a £250,000 unsecured loan from CAF Venturesome to rescue it from a serious cash flow problem: the charity had run into financial difficulties because it had made operating losses over a number of years which had decimated its cash reserves.

By October 2009, KIDS had transformed itself by eliminating loss-making contracts with local authorities; refinancing property assets; maintaining efficient management of costs; and exceeding fundraising targets.

By January 2010, KIDS was making healthy surpluses, with an increase of income year on year of 18%, and was able to repay its entire CAF Venturesome loan three years early.

East Lancs Moneyline (ELM) is a Community Development Finance Institution that provides affordable unsecured personal loans to individuals who are excluded from mainstream credit facilities and who would otherwise be forced to use high-cost credit (e.g. home-collected credit or payday loans).

Since 2002, ELM has provided over 14,200 loans to financially excluded individuals. Until recently ELM delivered its loans through five offices in the north of England: Blackburn, Burnley, Bury, Grimsby and St Helens.

Social Finance worked with ELM in 2009/10 to structure and market a seven-year bond to raise £640,000 of loan capital for five new ELM offices in south Wales (Moneyline Cymru). The capital was successfully raised in June 2010.

ELM's Welsh operations are expected to provide over 30,000 loans to financially excluded individuals over the life of the notes. ELM's customers currently save at least £63 in interest per £100 borrowed relative to the leading home-collected credit provider in the UK, generating a direct 45% social return. Income from interest paid by ELM's customers will be used to pay the financial coupon on the seven-year bond.

Alt Valley Community Trust (AVCT) is based in an economically deprived area of north-east Liverpool and focuses on creating training and employment opportunities for local people. Working with two sister organisations, AVCT runs a community-based training facility, the Communiversity, which is housed in a former old people's home and offers a broad curriculum, including subjects such as IT, construction, digital design and mechanics.

AVCT received initial social investment in 2003 of £200,000 (£100,000 loan and £100,000 grant) to develop and expand the Communiversity site by building a recording studio, conference centre, café, crèche and study support rooms.

In 2006, AVCT received an investment of £1 million to develop a vocational training centre for 14 to 19-year-olds. It has subsequently increased its training and learning contracts and turnover has grown from £0.7 million in 2003/04 to £1.8 million in 2009/10. AVCT has used this income to make loan repayments and to invest in providing additional services to the local community.

Investors are increasingly interested in social investment . . .

3.3 Already, within the mainstream investment market, the Sustainable and Responsible Investment (SRI) segment is growing rapidly, and is estimated to account for over £900 billion, or around 28% of all assets under management in the UK.[2] While clearly distinct from social investment – in that it seeks only to 'screen out' investments in sectors perceived to have negative effects, rather than aim for positive social value – the size and growth of SRI suggests that investors are interested in the social consequences of their investment decisions.

3.4 Some investors are going much further. For example, the charitable Panahpur Trust (refer to box overleaf) has made a commitment that all of its £5.5 million assets will be used for social investment. And recent research among very wealthy individuals shows that there is interest in social investment alongside commercial investment and philanthropy.[3]

3.5 Britain has the potential to be at the forefront of what, increasingly, is a global phenomenon. The US bank J.P.Morgan recently made a global commitment to invest in the social investment sector, and in recent research saw a clear opportunity for a new 'asset class' in what it terms 'impact investment'.[4] US President Obama has launched a $1 billion impact investment fund, which will, in partnership with private investors, invest growth capital in companies in underserved communities.[5] Some estimate that the total size of the global social investment market could reach $500 billion within the next decade.[6] And the establishment of a deeper social investment market globally could mobilise sustainable private sector capital for developing countries across multiple sectors, helping to create jobs and increase access to affordable products and services for the poor.

The **Panahpur Trust** was established in 1907. For most of the 20th century, it operated as a family trust making grants out of income on investments. The trust currently has assets of around £5.5 million.

Over the last six years, the trust has increasingly used its asset base to invest in social enterprises. In 2010, it became Britain's first foundation to commit to deploying 100% of its assets to social investment.

… intermediaries are emerging to serve the social investment market …

3.6 Social ventures often have less well-developed commercial propositions than mainstream small and medium-sized enterprises (SMEs), and need specialist support to innovate, market themselves and bid for contracts. So, in the last 10 years a range of social venture intermediaries such as Bridges Ventures, Charity Bank, Allia, the Young Foundation, thinkpublic and 3SC have been active in helping to meet these needs (refer to Table 3.1 for examples of the types of support).

3.7 For social ventures specifically seeking finance and business expertise there are broadly two types of intermediaries:

- **Intermediaries providing social finance** – these specialise in raising finance. In addition, many work with front-line ventures to help them become 'investment ready'. Reliable quantitative data on deal flow is scarce, but the Young Foundation estimates that the 10 largest social finance intermediaries help to channel around 96% of all social investment in the UK.[7]
- **Intermediaries providing expertise** – these specialise in building the business capability of social ventures. The support they provide includes help with business model refinement, investment readiness, access to public sector customers and more general assistance in building and running a small business.

Bridges Ventures is a private sector social investment company.

Investors range from institutions such as banks (HSBC, Co-operative Financial Services, Lloyds TSB, Barclays and Citigroup) and pension funds (such as Universities Superannuation Scheme and West Midlands Pension Fund), to wealthy individuals, families, trusts and endowments.

The first £40 million venture fund was raised in 2002, with a £20 million government commitment being used to leverage in a further £20 million from other sources. Based on its track record, Bridges Ventures raised a second fund of £75 million in 2007. Bridges Ventures has invested over £60 million, creating or sustaining an estimated 1,300 jobs.

Net internal rate of return from the 2002 fund was projected to be at least 10–12%.

In 2009, Bridges Ventures raised the Bridges Social Entrepreneurs Fund which provides equity-like investment and hands-on advice for scalable and sustainable social enterprises. The £11.75 million fund was raised from foundations and private investors, and is supported by a £3.9 million investment by the Office for Civil Society.

Charity Bank is a charity and a bank. By saving with Charity Bank, retail depositors can earn a modest amount of interest while benefiting communities throughout the UK, knowing that they can get their money back at the end of the term.

Charity Bank has over £50 million in deposits. Since its launch in 2002, the Bank has lent over £130 million, of which £85 million has been repaid to date.The Bank has have a low loan default rate of just 0.5%.

Returns depend on length of deposit, varying between 0.5% and 3%. Some investors opt for 0%. Depositors can take advantage of tax-efficient mechanisms such as ISAs and Community Interest Tax Relief.

Allia, a social profit society, has been issuing charitable bonds since 1999 to enable citizens to invest at minimal risk and put their money into their chosen cause without financial liability. The bonds work by pooling funds from individual and corporate investors. Some of the money is then lent to a secure social organisation (such as a social housing provider) while the remainder, after costs, is given in grants to charities, communities and wider civil society. After five years, the repayment of the loan with interest is returned to investors – equal to the amount they initially invested.

Allia (formerly Citylife) has raised £16 million of investment over the last 11 years through this model, and is expanding to launch a new fundraising service with new products.

Table 3.1: Types of support provided by social venture intermediaries

Type	Support provided	Examples
Finance	Investing for social and financial returns	CAF Venturesome provides debt and equity-like finance to social ventures. Community Development Finance Institutions provide loans to start-ups, individuals and enterprises for disadvantaged groups and disadvantaged areas.
Expertise	Helping social ventures to gain the skills and contacts they need	UnLtd Connect benefits social ventures by connecting them to professionals from all sectors of society who have volunteered their expertise.
Innovation	Identifying the problem, resourcing its solution	thinkpublic uses innovative, design-centred methods to develop solutions to social issues. Young Foundation combines research insights with expertise in supporting and spinning out innovative social ventures.
Monitoring	Measuring impact and effectiveness	Social Return on Investment measures social outputs, outcomes and impacts, and assigns monetary value to them.
Distribution	Helping social ventures to reach the people they need to	Eastside's 3SC brings together in partnership differing sizes of social ventures in order to bid for large, public sector contracts.

... and more sophisticated types of social finance products are being developed

3.8 Social finance intermediaries typically offer a range of financial products addressing different needs and requiring varying appetite for risk. This is summarised in Table 3.2, adapted from a report by CAF Venturesome.[8] The menu of products – debt, equity and combinations of the two – provides a range of types of financing appropriate to different stages of social venture growth.

But despite great progress to date, the social investment market remains embryonic and inefficient

3.9 Recent years have seen great progress. But there are many symptoms of dysfunction in what remains an embryonic and inefficient market, including:

- **Small market size.** Social investment in 2010 amounted to around £190 million, compared with £3.6 billion philanthropic grant funding, £13.1 billion individual giving and £55.3 billion of wider bank lending.[9] Individual deals tend to be very small indeed, with recent research suggesting that only 15% are over £15,000.[10] And only a small proportion of social venture start-ups are successful in obtaining early-stage finance from a social investor.[11]
- **Lack of investment readiness among social ventures.**[12,13,14] Some social ventures lack the appropriate financial and managerial skills to bid for, use and repay investments effectively. Some social finance intermediaries report that there is a shortage of viable investment propositions in parts of the market.[15]
- **Fragmented deal flow.** Social investment deals tend to be concentrated on the 'scale' phase of the business cycle, and less on the start-up or the traditional 'growth' phase. In particular, there is reported to be a scarcity of investments between £50,000 and £250,000.[16,17] There is also a lack of a specialist market for 'angel' investors, not least because there are few

Table 3.2: Types of finance available and relative risk to supplier

Financial need	Examples of suppliers	Type of finance	Financial risk to supplier
Fixed assets (buildings/equipment)	Barclays Bank Charity Bank The Royal Bank of Scotland Triodos Bank	Secured loan (mortgage)	Very low – asset backed
		Overdraft or standby facilities	Low – short-term cash flow cover
Working capital (short-term cash flow)	Big Issue Invest CAF Venturesome	Unsecured loans	Medium
Working capital (longer-term cash flow)	Big Issue Invest CAF Venturesome	Patient capital (long-term loans)	High – long wait (e.g. up to 10 years) but repayment expected
Growth capital (start-up and expansion)	Bridges Ventures CAF Venturesome Social Finance	Quasi-equity	Very high (substitute for equity)
	Bridges Ventures CAF Venturesome Communitybuilders	Equity	Very high (potential reward also high)
Various	The Baring Foundation Esmée Fairbairn Foundation	Grant	Complete – no repayment

Note: Some suppliers provide more than one type of finance.

exit opportunities. This is in contrast to the SME sector, where angel investment is better developed.[18]

- **Lack of standardised deal types.** Social investment deals are generally bespoke rather than standardised. This is reflected in much longer completion times than for comparable transactions for SMEs, estimated at 9–18 months from first contact, compared with 3–6 months.[19]
- **High transaction costs.** The bespoke nature of most deals imposes a high transaction cost on investments.[20] Social finance intermediaries estimate that typical transaction costs per deal are around £5,000. Moreover, the fact that most deals are relatively small – as noted above – means that transaction costs can be very high as a proportion of investment size.
- **Lack of information about deal flow.** The market lacks transparency and there is only very limited data about the social investment market today.[21] This lack of information is itself a symptom of market dysfunction.

The embryonic market symptoms are caused by underlying market failures

3.10 Many of the symptoms of this embryonic market reflect an underlying illness – what economists call 'market failures' or 'market imperfections'. These are listed at Annex B, but in summary they include:

- **imperfect information**, including: the difficulty potential investors experience in confidently assessing investees' claims for financial risk and return (information asymmetry); difficulty in calculating social return; use of different 'language' or terminologies between investment parties; or perception or presence of an unstable or unproven policy environment – for instance on tax incentives;
- **imperfect competition**, including: barriers to entry, such as cost or scarcity of specialist expertise and advice; barriers to exit, such as social ventures choosing legal structures which do not facilitate share ownership and therefore do not permit equity to be traded; lack of secondary markets, such as mechanisms for selling on and exchanging investment stakes; 'free' capital in the form of grants, which can distort demand for social investment; and variable commissioning practice in local and national government, which can make it difficult for social ventures to bid for public sector contracts;
- **externalities**, insofar that social value almost always accrues to third parties and not the investor or investee (although this is not necessarily a barrier for social investors as long as social return is known);
- **absence of public goods** that benefit all in a market – for example, industry associations for intermediaries, measurement systems for social value and industry standards; and
- **cultural and behavioural barriers**, including: the value placed on business skills by some social ventures; risk aversion among social ventures, such as perceived risk of financing models requiring repayment; and risk aversion among lenders – for instance, some lenders may perceive social investments as higher risk than they actually are.

3.11 We want to tackle these market failures so that we can accelerate the growth of social investment. The next two chapters set out the actions that we think will do this.

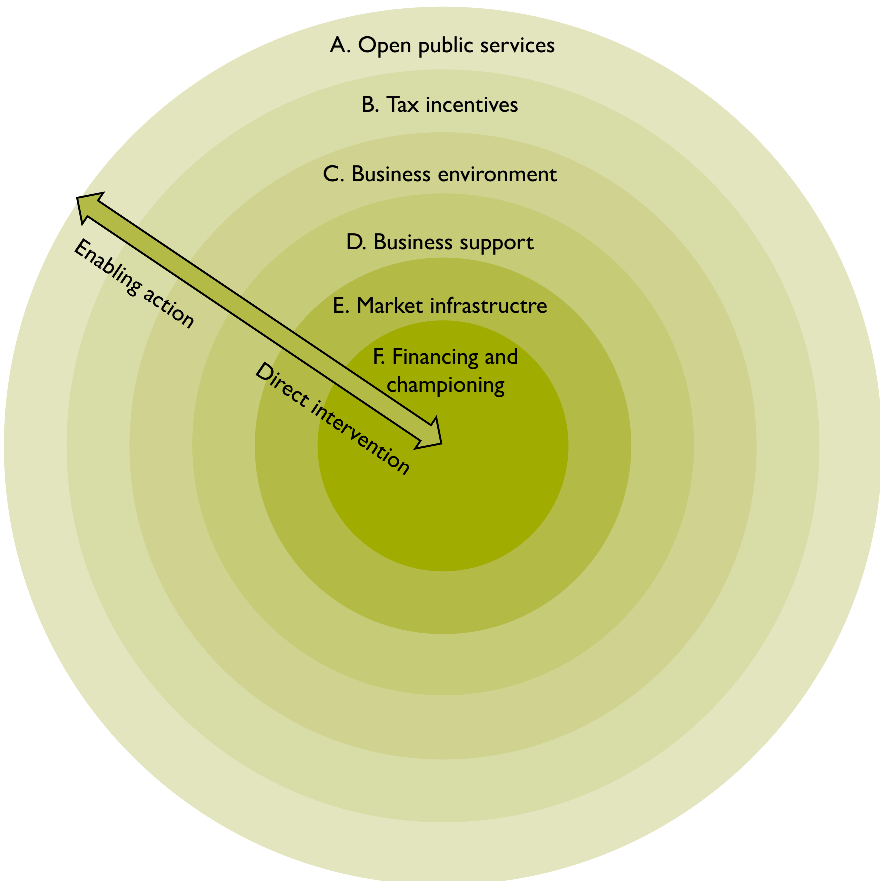
Chapter 4
A framework for action

4.1 As we have seen in Chapters 1 and 2, a bigger, more dynamic social investment market would have important benefits for both social ventures and wider society. But Chapter 3 has illustrated how fragile the market currently is. So we want to take action to accelerate the rate of market development.

There are six areas for action – from the broadest enabling reforms on public services and localism, to setting up the *Big Society Bank* itself

4.2 A six-part framework for action is set out in Figure 4.1 below. The outer rings denote broad enabling actions, including the Government's public service and localism agenda. The inner rings denote more direct intervention, ending in the core financing and championing role of the *Big Society Bank* itself.

Fig. 4.1: A framework for action in the social investment market



A: More open and localised public services will rely on and create opportunities for social ventures

4.3 Opening up public services and empowering communities are two key pillars of the Government's Big Society agenda. Both of these will create more opportunities for social ventures, helping to drive demand for social investment:

- Government will shortly publish a White Paper on **open public services**. Social ventures are well placed to play a leading role in creating a new landscape of public services. Central to a modern approach is the belief that we will only create responsive and efficient services if we can draw on the capacity and capabilities of the individuals, communities and providers that make up civil society. Social ventures have the potential to make a particularly strong contribution in delivering open public services as many work in partnership with communities and often best understand the needs and issues facing service users. Through mechanisms such as community budgets,[1] Local Integrated Services[2] and participatory budgeting,[3] social ventures can play a role as providers and shapers of public services.
- In the **Localism Bill**, subject to Parliamentary approval, we are creating new community 'rights'. One right is the '**Community Right to Buy**' – the right to bid to take over community assets. Another right is the '**Community Right to Challenge**' – the right to express an interest in taking over the running of a public service (which may in turn lead to a procurement exercise for that service). Government is currently publicly consulting on the detail of community 'rights', including what support could be provided to assist in using them effectively,[4] building on the Advancing Assets demonstration programme.[5]
- In parallel, we are establishing a range of '**Rights to Provide**' for public service workers to 'spin out' from the state and form their own enterprises that provide public services.[6] We expect many of these new enterprises to be social ventures. As they will be start-ups, many will require investment in order to realise their potential to provide responsive and efficient public services. To support this, the Government is encouraging a range of innovative ownership and investment models, including joint ventures and other types of partnerships. Furthermore, the Government is investing at least £10 million in the Mutual Support Programme, which will support the most promising mutuals to broker and secure social investment.[7]
- We will also **create incentives for prime contractors to invest in their sub-contractors**, both in terms of finance and expertise. Many social ventures already operate within complex supply chains, often as sub-contractors to larger private sector prime contractors. The Department for Work and Pensions is currently piloting a new supply chain management tool, known as Merlin. The Government recognises that this tool has significant potential to incentivise prime contractors to invest in capacity-building for their sub-contractors.
- In expanding and developing the use of **Payment by Results** across a range of public service areas, access to working capital could be a particular challenge to many smaller and more specialist providers. We will examine financing options for working with the private sector and social ventures on Payment by Results, for example through more Social Impact Bonds,[8] taking into account learning from a pilot scheme in Peterborough on prisoner re-offending.
- Graham Allen MP's **independent review of Early Intervention[9] is exploring a wide range of financing models, including social investment**, to scale up the impact and effectiveness of programmes for babies, children and young people to help break cycles of inter-generational underachievement.

B: Social investment benefits from appropriate tax incentives

4.4 A number of tax-related initiatives relevant to social investment already exist, although some are designed primarily to incentivise mainstream enterprise. They have had a positive, if limited, impact on incentivising social investment:

- The **Enterprise Investment Scheme** (EIS) is designed for mainstream enterprise and appeals to financially sophisticated investors. It enables investors to set 20% of the cost of shares against individual income tax liability. Although the EIS has contributed to attracting investment into social ventures, particularly into community-owned environmental energy products with an industrial and provident society (IPS) structure,[10,11] it is best suited to ventures that more closely resemble commercial enterprises. Many social ventures have a legal structure that does not permit the issuing of shares, and therefore they cannot benefit from EIS investment.[12]
- Another tax incentive for mainstream enterprise is the **Venture Capital Trust** (VCT) scheme. The scheme allows investors to set 30% of the cost of shares in a VCT against individual income tax liability, as well as relieving the income tax burden on dividend income. Its use for investment in social ventures has been limited.[13]
- **Community Investment Tax Relief** (CITR) is designed to encourage investment in disadvantaged areas. It gives tax relief to investors who invest in accredited Community Development Finance Institutions (CDFIs).[14] It allows tax relief on the equivalent of 5% of the amount invested per year, for up to five years. Although CITR has made a contribution to investment in CDFIs, some feel that the uptake of CITR has been disappointing, with only £63 million out of a total of £672 million of CDFI investment having been raised in this way since CITR was created in 2002.[15] The European Commission granted State Aid approval for CITR for 10 years (from 2002 to 2012) and this is currently being reviewed. The Government will work with stakeholders to consider the options available prior to reaching a final decision on re-notification.

4.5 We will continue to explore options for the future in the area of tax incentives. The lowering of the main rate of corporation tax to 24%, over four years, and the lowering of the small profits rate to 20%, in April 2011, will serve to encourage some social ventures that make a profit and will make clear our commitment to supporting SMEs more generally.

C: The right business environment is vital to social ventures

4.6 The business environment includes the legal and regulatory framework which governs how social ventures and investors act in the market.

4.7 **Clear guidance for charitable investments** will be vital. Charities hold a significant amount of capital – over £95 billion in income and endowment funds[16] – and freeing up just a fraction of this would release billions of pounds for social investment. To help charities invest with confidence, the Charity Commission published draft guidance on investment, for consultation, in December 2010.[17] This provides clarity about how charities may seek to further their aims through a range of investments, including social investment, and dispel some of the misconceptions around social investment. An example of a charity making social investments is the Esmée Fairbairn Foundation (EFF). It has been looking at blending social and financial returns on investments for some years. In 2008, EFF developed its £20 million Finance Fund, aiming to draw other investors into it and to demonstrate the potential of blended returns.

4.8 We have been working to explore the wider use of **community shares** as a way of attracting equity investment for local projects from within communities. The Community Shares and Bonds action research programme,[18] now in its final year, has contributed to the rapid growth of interest and activity in community investment. Ten projects are currently testing the idea, looking at barriers that could restrict their growth and how they can be overcome. The Development Trusts Association has proposed that there should be a co-regulatory[19] body to oversee the development of the community shares market. Such a body would promote, develop and monitor standards in the market, and provide an interface between government and regulators to develop policy and market information for consumers.

4.9 Appropriate legal structures for social ventures are also vital, and several choices are available. In particular, use of the **Community Interest Company** (CIC) structure has been growing in popularity since its establishment in 2004. There are now over 4,500 registered CICs, with net growth of nearly 1,000 CICs per year from 2008, up from just over 200 per year in 2005. The CIC structure provides a clear signal to investors that the enterprise operates for the benefit of the community, and that this social purpose is protected by law. As a bespoke legal structure for a social venture, each CIC must: pass a 'community interest test'; have an 'asset lock' (which restricts the transfer of assets out of the CIC, ultimately to ensure that they continue to be used for the benefit of the community); and cap the maximum dividend and interest payments it can make. The cap on dividend payments per share was raised to 20% in 2010.

4.10 Rules on **financial promotion** are increasingly important as the market grows. These rules require any invitation or inducement to invest to be approved either by the Financial Services Authority (FSA) or by a firm approved for such purposes by the FSA, although there are exemptions for certain types of legal structures such as IPSs. Some intermediary organisations have suggested a difficulty in approaching the public for funds due to the cost of authorising financial offer documentation. The Government will seek further evidence on the impact of the regulatory framework on social and community investment to assess whether it is proportionate.

4.11 We are looking at ways of **reducing the bureaucratic burden on small organisations** within the VCSE sector (for example, the contractual requirements for providing public services). Lord Hodgson is leading the Cutting Red Tape taskforce, which is taking forward this work. His report will be published in April 2011.

4.12 In addition, we are taking action in other areas that will broadly support social ventures, including:

- **simplifying tax for small businesses.** The Chancellor has tasked the Office of Tax Simplification with undertaking a review of small business taxation;[20]
- agreeing to the establishment of the first phase of 24 **Local Enterprise Partnerships**, where local authorities and local business leaders can come together to boost enterprise in their areas;[21]
- **reducing National Insurance contributions.** The threshold at which employers begin paying National Insurance contributions will rise from £110 to £136 in 2011/12;[22]
- **doubling the amount of rate relief available for small firms** for one year;[23] and
- signalling our intention for **25% of new government contracts to be awarded to SMEs.**[24]

4.13 We will continue to consider how we can do more to create a business environment that is both favourable to existing social ventures and will aid start-up of new ones.

D: Social ventures need support to improve their investment readiness and their business capability

4.14 Many social entrepreneurs feel that the provision of investment readiness and business capability support is a more pressing need than the provision of finance itself.[25] Examples of such support include: help with developing a business plan; training in financial skills, for example help with making cash flow projections; help with building credible, rigorous business cases; and help with understanding the types of capital available, as appropriate to the needs of individual social ventures, and where to get it.

4.15 Social ventures can, in theory, already access a range of different support services, including:

- **mainstream business support** – the principal national source of which is the Business Link website;[26]
- **local business support** – for example through local enterprise agencies (which are not-for-profit organisations delivering business support services under contract to public and private sector bodies), and chambers of commerce;

- **mainstream professional services** – social ventures can pay for advice from lawyers, accountants, careers advisers, management consultants and other professional service providers;
- **public and private pro bono corporate support** – through established schemes such as Business in the Community's employee volunteering programme, which provides professional development opportunities for professionals in schools and community groups; the National Council for Voluntary Organisations work shadowing scheme for civil servants; and UnLtd Connect, which provides a brokerage service matching skilled business professionals with social entrepreneurs;
- **support bodies specifically for social ventures** – these include representative bodies;[27] organisations that maintain trading websites, such as the Social Enterprise Mark Company; training support bodies, such as Social Enterprise Training and Support; consultancy support businesses, such as Eastside Consulting; and innovation hubs, such as Bromley by Bow Centre's 'Enterprise Barn', among others; and
- **finance intermediaries** – these include signposting services, such as Funding Central (which provides advice and support for civil society organisations wishing to access grant or loan finance), as well as specialist intermediaries that provide a mix of business and investment readiness support, such as UnLtd Connect and Resonance.

4.16 But in practice, many social ventures struggle to access the support they really need. Their lack of ability or willingness to pay for support is one obvious barrier. Low awareness among most professional services and business capability providers of the needs specific to social ventures is another problem. Greater access to angel investors – who provide new companies, particularly in the commercial sector, with intensive business coaching and financial investment – is one way to get social ventures the support they need. But there is more we can do:

- In the short term, we can make the support services that are available **easier to find and better connected**. For instance, the *Big Society Bank* (refer to Chapter 5) could signpost sources of support to social ventures and construct national networks, including a peer network to help social ventures help one another.
- We also need to improve the **sustainability of business capability services**. The National Endowment for Science, Technology and the Arts (NESTA) Social Venture Intermediary Fund, which will provide grants to a portfolio of intermediaries to support them to become sustainable and scalable businesses, is a good example of the social investment sector responding to this demand.
- The Prime Minister launched **Every Business Commits** in December 2010. This calls on business to go beyond corporate and social responsibility and help to create a more sustainable and community-centred approach. Business is asked to help in: reducing carbon and protecting the environment; improving skills and creating jobs; supporting their community; improving quality of life and well-being; and supporting SMEs. The actions that businesses could take include investing in future skills more widely in their community or partner organisations; or mentoring a social enterprise.[28]
- We would like to see **more pro bono support** from the commercial and public sectors. There is already an appetite among commercial sector organisations to help in this way – for example, the Private Equity Foundation recently provided support to enable the merger of Fairbridge and the Prince's Trust. We want to harness this more effectively, by supporting and working with existing secondment schemes to connect the expertise in the commercial sector with social ventures.
- The 2010 *Local Growth* White Paper[29] encourages social enterprises to apply to the **Regional Growth Fund** – a £1.4 billion fund running to April 2014 that aims to encourage enterprise and jobs in places that are heavily reliant on the public sector. Investment readiness and business capability providers, for example, might consider applying to the fund to deliver services to social ventures in a specific geographical region.

- BIS is working with the UK trade bodies, mentoring organisations and the British Bankers' Association (BBA) to build a network of mentors, with the aim of reaching a **total network of 40,000 mentors**. In addition, working with these organisations the BBA is constructing a web portal mentoring gateway for small businesses, which will also be open to social enterprises. This will enable businesses and social enterprises to secure the right mentor for their needs. The launch of the website is planned for June 2011.
- Finally, the Government is currently looking at its broader **support for VCSE organisations**, to help them adapt and take advantage of new forms of finance and opportunities for public service delivery. As part of this we are considering plans for a bursary scheme that puts front-line organisations – which could include social ventures – in charge of purchasing support that is most appropriate to their own needs. Additionally, the Government will shortly be consulting on proposed policy directions for the Big Lottery Fund. We want to explore how it might build on existing work around social finance to develop the social investment market.

E: Better market infrastructure will help social investment to grow

4.17 There is a range of measures which could help to build the infrastructure that is essential to a mature, well-functioning market:

- **wider-ranging and more freely available market analysis and research** – on precise flows of social investment, and its impact on social ventures, as well as the effectiveness of measures to address market failure. There is also a need for work to identify investment opportunities, by finding the gaps in existing provision and areas in which finance is most needed;
- **creation of a single web portal or gateway.** The portal would help social ventures to connect with the right sources of finance, business capability or investment readiness support. In time, the portal could serve as a broader gateway: facilitating recruitment and internships to social ventures and intermediaries; and connecting social ventures to expertise offered by other social ventures, private sector organisations, universities or the general public. There may also be scope to use the portal as a platform to build social venture consortia to bid for large-scale contracts, or to help develop sector-specific networks. The portal could be independently run on a self-financing business model, and there could initially be a role for the *Big Society Bank* in achieving this (refer to Chapter 5);
- **development of better measures of social return** – this may involve a convening role to bring together investors, social venture intermediaries and social ventures, or working to identify the most effective and robust initiatives currently in the marketplace and potentially backing and expanding them. Existing initiatives include the US-based Impact Reporting and Investment Standards (IRIS)[30] and the Social Return on Investment (SROI) approach developed by a collaboration of individuals and organisations in the UK (such as the membership organisation the SROI Network).[31] These could be developed on a sector-specific basis, as opposed to there being nationally relevant metrics that cut across all the sectors in which social ventures operate (health, education, etc.). A menu of options for measurement methodology will need to operate according to what investors need, with greater rigour being applied to those that require it;
- **introduction of social risk ratings** – creation of a new organisation, or support for existing ones, to help establish a system that apportions the appropriate rate of risk (in terms of social outcomes) to investment opportunities;
- **development of secondary markets** – piloting of a social stock exchange, or incentives for existing stock exchanges to develop an exchange of stocks in social ventures;
- **creation of a trade association for social venture intermediaries** – to act as a convening body, raising the profile of social ventures and increasing the credibility of social venture intermediaries. This could be similar to the Community Development Finance Association (cdfa), which represents CDFIs.

Other comparable organisations include the Consultative Group to Assist the Poor in the microfinance sector and the British Venture Capital Association for venture capitalists; and

- **establishment of a 'social finance city'** – a clustering of social and mainstream investment institutions, social venture intermediaries and organisations promoting social investment infrastructure could create a social investment hub. Clustering organisations like this could have an 'incubation' effect on the industry and may lead to the development of separate hubs across the country.

These actions will help the acceleration of the social investment market's development

4.18 However, the five areas for action discussed above may still result in the market developing too slowly. So, we see a focused role for a new institution to act directly in improving the supply of finance, and to act as a champion of the whole social investment market. That institution is the *Big Society Bank*, subject of the next chapter.

Chapter 5
The *Big Society Bank*

5.1 The actions set out in Chapter 4 will help to create a more enabling environment for social ventures, investors and intermediaries. But given the newness of the market, more needs to be done to champion and catalyse investment to build a sustainable, thriving market. That is why we want a *Big Society Bank*.

5.2 This chapter sets out in more detail:

- the *Bank's* mission and operating principles;
- what the *Bank* will aim to do – as an investor and champion;
- measures of the *Bank's* success; and
- how the *Bank* is being set up.

The *Bank* will have a clear social mission and four operating principles: independence, acting as a wholesaler, transparency and self-sufficiency

5.3 The *Bank's* **mission** will be to catalyse the growth of a sustainable social investment market, making it easier for social ventures to access the finance and advice they need – at all stages of their development.

5.4 In delivering its mission, the *Bank* must have a clear set of **operating principles**. Drawing on responses to the 2009 consultation on a 'Social Investment Wholesale Bank'[1] and subsequent discussions, we think these principles must be:

- **independence from government** – we expect the *Bank* to be a private sector body, independent of government but with a 'locked-in' social mission. We want it to be able to respond flexibly to the needs of the market. It will be free to:
  - decide how to achieve its mission – and what activities are most effective in catalysing a sustainable social investment market;
  - decide how to invest its money – the criteria for prioritising investments, the level of risk taken, and the financial and social returns targeted;
  - have the ability to raise additional capital if required;
  - make appointments and set salaries and employment terms and conditions;
  - manage its budget and operating costs; and
  - advise government (in a championing role – as detailed below);
- **acting as a 'wholesaler'**[2] – the *Big Society Bank* will act as a wholesaler, in accordance with the Dormant Bank and Building Society Accounts Act 2008. This means that it will not invest directly in individual, front-line social ventures. Nor will it take deposits or offer personal accounts. Direct investment would involve direct competition with intermediaries, which could potentially distort the market and undermine its long-term development and sustainability. So, the *Big Society Bank* will invest in products developed by intermediaries and encourage

others to do likewise, thus increasing the pool of capital available to front-line social ventures. We say more about the *Bank's* financing activities later in this chapter;

- **transparency** – the *Big Society Bank* will need clear and transparent reporting arrangements. The *Bank* will publish annual accounts including details of the financial and social impact of its investments. It will have an important role in promoting industry best practice in this area. Transparency is important for two reasons:
  – first, taxpayers have a right to know how funds from dormant accounts are being used, and what value society is getting; and
  – second, accessible information about investments is important to build investor confidence in the market. It will help intermediaries to refine the way they assess and communicate risk and return to investors; it will help investors to decide where to allocate their money; and it will help existing and new social ventures to understand what types of finance work best for their needs; and
- **self-sufficiency** – the *Big Society Bank* needs to be financially self-sufficient – that is, able to cover its operating costs and make investments in line with its core mission. Financial self-sufficiency is important for two reasons:
  – first, we are in no doubt that growing a sustainable social investment market is a long-term project. So, the *Bank* will need to be around for many years – though not necessarily forever – and will need a business model that protects its long-term viability and independence; and
  – second, the *Bank* must help prove that putting money into social ventures can generate both social impact and real financial returns. This is vital for building market confidence in what is a new 'asset class'. It is also part of building the *Bank's* own investment track record, and thus its ability to raise more capital if required.

So in practice we do not envisage that the *Bank* will make grants, even to intermediary organisations, and in time we would expect the *Bank* to cover its operating costs from the yield on its investments.

The precise levels of investment risk and return will be for the management of the *Bank* to determine. The *Bank's* mission of growing a sustainable market will sometimes require it to make investments that are more patient (long-term), higher risk (e.g. differentiated or subordinated positions) and/or lower return relative to more mainstream, shareholder-driven financial institutions. As such, in early years we might expect some attrition of the *Bank's* initial capital.

The *Bank* will be both a wholesale investor and a champion of the market

5.5 In order to achieve its core mission – to catalyse the growth of a sustainable social investment market – the *Bank* will do two main things:

- **act as wholesale investor** – investing in funds for front-line social ventures, funds for intermediaries, and funds for new market vehicles and infrastructure; and
- **be a robust champion** of the social investment market – with the public, to stakeholders, and to investors.

The *Bank* could invest in funds for front-line social ventures, for intermediaries and for development of new market vehicles and infrastructure

5.6 In order to accelerate the growth of the market, we expect the *Bank* to focus its investment activity in three main areas. Examples of each are given in Tables 5.1–5.6 and are drawn from proposals selected for development by NESTA's Big Society Finance Fund.

- **Investment funds for front-line social ventures** – these would increase the supply of capital available to front-line social ventures. The funds could have specific 'themes', such as supporting youth opportunities, financial inclusion, or the purchase of community assets (refer to Tables 5.1 and 5.2). Alternatively, funds could aim to develop specific capabilities among social ventures, such as an innovation fund or a working capital fund for public sector contracting (refer to example in Table 5.3).

Table 5.1: Proposal from Finance South East with Resonance 'Business Angel Co-investment Fund'

The opportunity: to invest in social enterprises needing early stage expansion capital and to stimulate mainstream business angel interest in social ventures			
Size of investments to recipients • Minimum investment: £25,000 • Maximum: £100,000 • In the form of debt, quasi-equity and equity	**Risk** • Typical risks as experienced by mainstream angel investors	**Target investors** • Philanthropic and charitable institutions • Corporate investors	**Potential role of the *Bank*** • Enable a small pilot fund to attract further business angel investment to the social enterprise sector
Social impact • Enhance the supply of growth funding to ambitious enterprises which are economically robust and deliver significant positive social impact		**Financial return** • Varied • Linked to risk and the deal structure • Anticipated 10% p.a. for loans • Higher for equity	

Source: Application to NESTA Big Society Finance Fund

Table 5.2: Proposal from Fair Finance

The opportunity: to provide accessible, affordable and responsible financial services to the financially excluded			
Size of investments to recipients • At least £20,000 individually (£750,000 in total) • Bank's financing debt facilities of £2 million	**Risk** • High, due to lack of data	**Target investors** • Equity from social investors (high net worth individuals, corporate investors, general public) • Commercial debt investors (including high street banks)	**Potential role of the *Bank*** • £0.5 million of subordinated mezzanine debt to limit senior debt holders' exposure, and to build confidence in the fund's stability
Social impact • High social impact from addressing market problems in the access of finance for poor and marginalised communities		**Financial return** • Social investors: capped return of 5% • Bank lenders: commercial market-based rate (currently 5–6%), with 5 year renewable interest only loans	

Source: Application to NESTA Big Society Finance Fund

Table 5.3: Proposal from Big Issue Invest in partnership with PwC

The opportunity: a Payment by Results fund, structured as a venture capital trust in partnership with a prime contractor to DWP, to support social enterprises and voluntary organisations bidding for public sector contracts			
Size of investments to recipients • Unsecured working capital loans in the range of £50,000 to £500,000	**Risk** • Viewed as high risk by high street banks	**Target investors** • High street banks • Building societies	**Potential role of the *Bank*** • First loss capital to underwrite the initial perceived risk to investors • Underwrite the initial set-up costs and costs of setting up the contract management and information systems
Social impact • Expected in the form of measurable success in moving people from welfare into sustainable employment, including the long-term unemployed and those with complex needs		**Financial return** • Repayment is linked to revenue performance which in turn will link to contract performance	

Source: Application to NESTA Big Society Finance Fund

- **Investment funds for social venture intermediaries** – these are likely to focus on supporting the viability and sustainability of intermediaries themselves. Priorities might include funds to support intermediaries doing investment readiness work, where this is done in a commercial but not yet sustainable model (and would complement the support schemes proposed in Chapter 4). Or funds could provide intermediaries with working capital, to support them to make onward investments – the 'Resonance' and 'Five Lamps' applications to NESTA's Big Society Finance Fund would be examples of this (refer to Tables 5.4 and 5.5).

Table 5.4: Proposal from Resonance 'Community Share Underwriting Fund'

The opportunity: an intermediary that enables communities with viable business plans and capital-raising proposals to acquire assets (e.g. community property, supported housing, community farm/forestry and renewables), by underwriting their community share offer			
Size of investments to recipients • Average investment: £300,000	**Risk** • Low – investments must be asset-backed and require track record	**Target investors** • Charitable trusts	**Potential role of the *Bank*** • Cornerstone investor
Social impact • 15 autistic adults supported to live independently • 11 affordable homes • 220 tonnes of carbon saved • 5,000 sq ft affordable workspace for VCSEs		**Financial return** • Up to 6%	

Source: Application to NESTA Big Society Finance Fund

Table 5.5: Proposal from Five Lamps 'Expansion of Community Development Finance Institution (CDFI)'

The opportunity: a £3 million regional community bond issue at c.4% to finance an expansion of the largest CDFI in the North-East of England. Five Lamps would lend capital on to grow unsecured lending to financially excluded individuals living in the North-East			
Size of investments to recipients • Average investment: £415 over 12 months plus first stage debt advice and support	**Risk** • Delinquency and bad debt	**Target investors** • Charitable foundations • High net worth individuals • Housing organisations • Pension funds • Public bodies	**Potential role of the *Bank*** • Investment in business plan and prospectus development • Cornerstone investor
Social impact • The money raised will fund growth in lending activity to financially excluded adults in the North-East – enabling up to 50,000 loans per annum by 2014/15		**Financial return** • Eight-year bond (c.3–3.5% p.a.) • Target amount up to £1.5 million	

Source: Application to NESTA Big Society Finance Fund

- **Investment funds to develop new investment vehicles and to build market infrastructure** – these funds would aim to stimulate and develop new investment vehicles, such as 'Social ISAs' or Social Impact Bonds (refer to Table 5.6) and to support development of market infrastructure, such as impact measurement, exchange platforms and investment portals.

Table 5.6: Proposal from Social Finance: Social Impact Bond in health

The opportunity: to invest in the development of Social Impact Bonds in health and social care services. The structure of the fund is designed to reduce the risk of product development while enabling repayment where possible	
Potential role of the *Bank* • Up to £250,000 of development capital to create products and financial structures that could be taken to the wider social investment market	
Social impact • More personalised, local health services that help patients to improve and manage their own health, in order to overcome an over-reliance on hospital services that are expensive for taxpayers and less pleasant for patients	**Financial return** • Capital repayments and a modest return spread across a number of health-related Social Impact Bonds as they are launched, mitigating the development risk

Source: Application to NESTA Big Society Finance Fund

5.7 Among its high-level objectives, the *Bank* will have a special mandate to give priority to supporting the development of community-led, social enterprise initiatives to improve opportunities for young people. However, as an independent institution, it will be free to make its own investment decisions, based on the quality of opportunities presented by the market.

The *Bank* could invest as a co-investor, underwriter or guarantor

5.8 We expect the *Bank* to be free to utilise a full range of financial instruments – not just providing loans, but also taking equity stakes as well as using quasi-equity and bond instruments.

5.9 Similarly, we expect the *Bank* to tailor its approach in order to encourage investment from others and to maximise its impact as the market matures. Therefore it may choose to act in different ways in different parts of the market (by co-investing, underwriting or guaranteeing deals) and take on varying degrees of risk. We do not expect the *Bank* to operate in areas where there is demonstrably a sufficient supply of private sector capital.

5.10 As a **co-investor**, the *Bank* might invest:

- alongside other investors (match funding) – to send a signal to the market;
- as a cornerstone investor ('first in') – to draw in other investors;
- as a capstone investor ('last in') – to ensure a deal goes ahead where there are insufficient investors to achieve the level of finance needed; and
- by taking on differentiated return (e.g. lower interest rates) or subordinated risk (e.g. junior debt, deferred shareholdings) – to give other investors more confidence of a financial return, should the investment underperform.

5.11 As an **underwriter**, the *Bank* could use its balance sheet to hold products before distribution into the market, such as a Social Impact Bond, and take the risk of purchasing the product before redistributing it into the market.

5.12 As a **guarantor**, in time the *Bank* might offer to secure others' investments by guaranteeing to pay back some or all of their initial investment, should the fund underperform. This could help to encourage new investors into the market, or stimulate investment into new or higher-risk products. The *Bank* would expect a financial return for this activity.

The *Bank* will be a champion for the social investment market

5.13 In addition to its investment activity, the *Bank* will take a major role in championing social investment. We expect the *Bank* to be able to 'talk the language' of both social ventures and mainstream financiers, and thus to be in a unique position to connect the two. As an independent body, the *Bank* will have a key role in supporting other areas of action outlined in Chapter 4. We would expect the *Bank* to:

- **facilitate a gateway** to the market for social ventures – signposting, through a new web portal, sources of finance and support from organisations, and constructing national networks of business angels, mentors and experts;
- **advise government** – on opportunities to open up public services to social ventures; on new incentives for investors; and on reforms to the regulatory and business environment;
- **keep abreast of emerging government policy** – including new models of financing public service delivery, and co-ordinating a supply of investment for such models;
- **commission and communicate research** – into market development and opportunities, such as barriers to growth, new investment opportunities and new product development (such as Social Impact Bonds);
- **share expertise** – for example to align 'investment readiness' grant programmes and other government initiatives with the mission of the *Bank*;
- **sponsor and promulgate best practice** – especially in the measurement of social impact and assessment of risk; and

- **promote the social investment industry** throughout the country – not just in London and the South-East – and potentially take our expertise abroad.

5.14 In the longer term, as the social investment market matures, the *Bank* may evolve to focus chiefly on helping to standardise terms, frameworks and products, to make it easier for investors to understand and engage with them. Through its guidance and actions, the *Bank* could signal to the market the suitability of products for investment, as well as pricing structures and rates of return. This could help stimulate activity even where the *Bank* is no longer acting as wholesale investor.

The success of the *Bank* will be judged by its impact

5.15 The success of the *Big Society Bank* will be judged by two key factors:

- the growth and sustainability of the social investment market (its liquidity, efficiency and confidence); and
- the social impact of the investments the *Bank* makes, where this can be determined directly.

Work to set up the *Bank* is on track, with some of its functions in place from April 2011

5.16 A consultation on the functions and design of a 'Social Investment Wholesale Bank' took place in 2009. In the last few months work has accelerated, and some of the *Big Society Bank's* functions will be in place in April 2011. And we will now work with leading social investment experts to develop a proposal for the establishment of the *Big Society Bank* as an independent private sector organisation.

5.17 We have just announced that **the largest UK banks will support the establishment of the *Big Society Bank* by injecting £200 million of capital** over two years, commencing in 2011. This funding will be subject to the business plan and structure of the *Big Society Bank*. It will not affect the *Bank's* operational independence.

5.18 The *Bank* will also be **funded with money released through the dormant accounts scheme**, the provision of which the major UK banks also support. The BBA estimates that such accounts hold around £400 million. The Dormant Bank and Building Societies Act 2008 set a framework under which money in dormant bank and building society accounts can be distributed for the benefit of the community, while ensuring that account holders can always reclaim their money.

5.19 In allocating these funds, the last Government gave a low priority to its concept of a Social Investment Bank, with a maximum capitalisation of £75 million. We want to make it a higher priority. So, in July 2010, the Prime Minister announced that all of the dormant accounts money available for spending in England will go to fund the *Big Society Bank*. The Devolved Administrations will determine how their portion of dormant accounts money will be spent, in line with the legislation and their own social and environmental spending priorities.

5.20 Co-operative Financial Services (CFS) has agreed to set up a Reclaim Fund, to enable the release of dormant accounts money. CFS has submitted an application to the FSA for authorisation of the Reclaim Fund.

5.21 The Reclaim Fund will release surplus money to the Big Lottery Fund as distributor as named in the legislation. This Government has committed that all of the English portion of this money will be directed to the *Big Society Bank*. CFS has previously estimated that, in the first year, the Reclaim Fund will release in the region of £60–100 million of surplus money, with the first release likely to take place in mid-2011. This will be followed by further significant releases of money, dependent on the rate at which people reclaim dormant accounts. In time, there should also be a small, steady stream of annual funding as additional accounts become newly dormant.

5.22 We are currently working to secure the State Aid approvals from the European Commission that we need in order to capitalise an independent *Big Society Bank* with dormant accounts money and to provide it with the flexibility it needs to grow the market.[3] In advance of this, we are working with the

Big Lottery Fund on interim arrangements that will enable investments to be made as soon as dormant accounts money becomes available in mid-2011.

5.23 In summary, this chapter has set out our thinking on the mission, principles and role of the *Bank* in accelerating the development of the social investment market. Chapter 6 sets out the next steps we need to take, and the role we envisage for others in developing the market.

Chapter 6
Next steps

We will work with leading social investment experts to take forward aspects of this strategy

6.1 The Government will now work with leading individuals, as well as with intermediaries and other key players in the social investment market, to map out:

- which parts of our framework for action should be taken forward by the *Big Society Bank*, and which by wider government in concert with others;
- within each area of the framework, which interventions should be prioritised; and
- what the business model, capital structure and governance arrangements of the *Big Society Bank* should be in order to ensure that its operations are sustainable.

Ultimately everyone will need to be part of building a dynamic social investment market

6.2 Realising our vision of a dynamic social investment market will rely on everyone playing their part:

- **social ventures** are, of course, at the heart of this strategy. Where appropriate, we want to see them take advantage of new opportunities to access finance for investment, so that they can grow or replicate, and deliver more social value;
- **individual citizens** control huge assets in the form of savings and pension assets. We hope that people will take advantage of emerging opportunities to put some of this money to work in order to deliver social return and benefit society;
- **mainstream financial institutions** have the opportunity to create a new range of financial services and products. They need to dedicate human and capital resources to social investment, to create new products, to build knowledge and expertise and to leverage their distribution networks to deliver this new class of assets to mainstream investors;
- **charitable foundations** are the investors that are arguably closest to the social investment market. We want to see them take a more ambitious approach to social investment, facilitated by new guidance from the Charity Commission;
- **social venture intermediaries** will play an even more important role than at present as the social investment market develops. We want to see them work together to raise their profile and credibility, for example by creating a trade association with entry standards and a code of conduct. We would also like to see intermediaries work with government to embed standards for measuring social return; and
- **professional bodies and business networks** can help by building up pro bono networks of professional support for social venture intermediaries and social ventures – in particular outside the South-East.

Success will look like a bigger market …

6.3 We hope to see a bigger market, which is likely to mean that:

- there is an **increase in the overall amount of social investment available** to social ventures, including investment in the intermediary organisations which support them;
- **the public are more aware** of the opportunities for social investment and the ways in which they can use their money to do good while getting a financial return; and people better understand the level of risk involved and what they get for their money;
- the **number of new social venture intermediaries and social ventures entering the market increases**, contributing to an increase in the total number of social ventures, while allowing for the failure and exit of some organisations;
- social ventures account for a **greater proportion of GDP and employment** across the economy;
- a **greater proportion of social ventures are bidding for and winning public service contracts**, as consortia if necessary; and
- there is an **increase in the number of customers and users** reached as a result of the investments made.

… that works more efficiently

6.4 We hope that the market will function more efficiently, which is likely to mean that:

- **social ventures and investors find it easier to do business** and average deal transaction times and costs fall;
- **deal volumes and values increase** year on year;
- there are **better measurement systems** for quantifying social return and rating the risk of investment opportunities and intermediary organisations; and
- the **need for external investment readiness support eventually decreases** as more social ventures develop advanced skills in finance and business.

Annex A
Profiles of social venture intermediaries

This section includes short profiles of some of the largest social venture intermediaries.[1]

Big Issue Invest

www.bigissueinvest.com

Style of fund	Debt fund and growth capital fund/social venture fund
Capacity of fund	Debt fund: £5 million Venture fund: aiming for £10 million
Sources of capital	Charitable foundations, multiple high net worth individuals (HNWIs), UK Government, and banks and financial institutions
Fund structure	Venture fund: English limited partnership with Big Issue Social Investments Limited as general partner and CCLA as Financial Services Authority (FSA) registered fund manager. All deal origination, due diligence and monitoring contracted to Big Issue Invest as appointed representative of CCLA.
Number in portfolio	Over 25
Investee life stage	Growth, expansion
Typical deal size	£100,000 to £500,000
Risk profile	Working capital, growth capital
Financial instruments used	Secured, unsecured loans, equity/equity-like investments
Selection criteria	Investees will typically have: clear social purpose; compelling business model; strong management; demonstrable and sustainable revenue stream and growth potential; history of trading for three years and a turnover of over £250,000; or be a start-up organisation with a robust business plan and strong cash flow projections.

Bridges Ventures

www.bridgesventures.com

The first fund of Bridges Ventures was started with £20 million from the Government in 2002. Bridges Ventures focuses entirely on funds that aim to achieve dedicated social and/or environmental goals, as well as financial returns for investors.

In total, Bridges Ventures has around £150 million under management, which is split between Bridges Venture Funds I and II, the Bridges Sustainable Property Fund and the Bridges Social Entrepreneurs Fund.

1. Bridges Venture Funds I and II

Style of fund	Social venture fund
Capacity of fund	£60 million
Sources of capital	Banks, pension funds, trusts and endowments, corporate investors and multiple HNWIs
Fund structure	Limited partnership
Number in portfolio	30
Investee life stage	Early stage, expansion, property backed and late stage
Typical deal size	£500,000 to £10 million
Risk profile	Growth capital
Financial instruments used	Primarily equity investments
Selection criteria	Supports organisations which: have the potential to substantially increase value in three to five years; require growth capital, early stage, MBOs, MBIs; require £500,000 to £10 million in investment; are based in one of the most deprived areas of the UK and are connected with the local economy by employment, market or supply chain; are businesses outside of the above but with strong positive social/environmental benefits in the areas of health, education and the environment.

2. Bridges Social Entrepreneurs Fund

Style of fund	Social venture fund
Capacity of fund	£9 million
Sources of capital	Charitable foundations, multiple HNWIs, UK Government
Fund structure	Limited partnership
Number in portfolio	2
Investee life stage	Primarily growth stage, although the fund has backed a start-up
Typical deal size	£500,000 to £1 million
Risk profile	Primarily expansion capital
Financial instruments used	Equity/equity-like investments
Selection criteria	Invests in social enterprises based in England that have: a clear social mission (protected in their legal structure); the ability to grow to scale and increase their social value; a financially sustainable model; the ability to generate surpluses to repay financing; and a strong management team. Investments are up to £1.5 million per social enterprise, structured as flexible and tailored investments, usually in the form of quasi-equity and repayable with an appropriate return through the social enterprise's trading activities.

CAF Venturesome

www.cafonline.org/venturesome

CAF Venturesome is the social investment arm of the Charities Aid Foundation. It seeks to fill the gap between grant-making and bank loans.

Style of fund	Social venture fund
Capacity of fund	£10 million
Sources of capital	Charitable foundations, multiple HNWIs (12 external investors in total)
Fund structure	Multiple trusts
Number in portfolio	Around 60
Investee life stage	Mature, growing, expansion and turnaround
Typical deal size	£25,000 to £250,000
Risk profile	Working capital, growth capital
Financial instruments used	Unsecured loans, equity-like investments, standby facilities
Selection criteria	Supports organisations which: are registered in the UK; can clearly articulate their charitable purpose and social value (organisations do not have to be registered charities but do need to be of charitable purpose); have at least one year's history of trading and/or income; are looking for between £25,000 and £250,000; and have a legal structure which allows them to take on debt/equity funding.

Charity Bank

www.charitybank.org

Charity Bank was created to provide normal banking services to charities (and some other voluntary organisations or social enterprises), which are typically either excluded from or priced out of the commercial/retail banking sector. Where products such as loans are offered in competition with the commercial sector, the Bank seeks to keep interest rates or fees below those of the market.

Style of fund	Charity and social enterprise loans
Capacity of fund	£65 million
Sources of capital	Trusts, institutional and HNWI funders and donations
Fund structure	Regulated bank
Number in portfolio	Over 350
Investee life stage	Growth, expansion, transformation, stabilisation
Typical deal size	£50,000 to £2 million
Risk profile	Working capital, asset acquisition, bridging
Financial instruments used	Secured and unsecured loans
Selection criteria	Can lend to any organisation that is either a registered or exempt charity, as well as to community associations, voluntary organisations, community businesses, social enterprises or social landlords as long as the purpose of the loan is charitable. Also lends to 'for profit' companies if the loan is for exclusively charitable purposes. General banking criteria plus social impact.

Co-operative and Community Finance

www.co-opandcommunityfinance.coop

Co-operative and Community Finance exists to serve exclusively the co-operative and social enterprise sector. It dates back to 1973 and was born out of a series of informal meetings in Northampton inspired by the principles and practice of one of the largest common ownership co-operatives in the UK – Scott Bader. In 1976, government support, through the Industrial Common Ownership Act 1976, set aside a further £250,000 of funding to lend to co-operative enterprises. In 1987, a PLC share issue raised £550,000. Further issues in 1997 and 2007 increased the fund total to £1.3 million. In 1994 an industrial and provident society (IPS) withdrawable share offer raised a further £750,000. With full FSA authorisation, Co-operative and Community Finance also manages funds on behalf of other organisations.

Style of fund	Co-operative social enterprise loans
Capacity of fund	£4 million: £2 million on loan, £2 million in bank
Sources of capital	Individuals and corporates – Community Investment Tax Relief (CITR) borrowing
Fund structure	PLC, IPS Ltd
Number in portfolio	130
Investee life stage	Growth, expansion
Typical deal size	£10,000 to £150,000
Risk profile	Working capital, growth capital
Financial instruments used	Secured and unsecured loans
Selection criteria	Organisations must have a commitment to democracy and open membership. They must also have a clear social purpose, usually enshrined in their constitution. General business lending criteria apply.

The Key Fund

www.thekeyfund.co.uk

The Key Fund was established with government and EU support, particularly with EU structural funds for deprived areas.

Style of fund	Finance for social enterprise
Capacity of fund	Around £7 million
Sources of capital	European structural funds, private trust, mainstream finance
Fund structure	Company limited by guarantee
Number in portfolio	168
Investee life stage	Start-up, growth, expansion
Typical deal size	£10,000 to £150,000
Risk profile	Start-up capital, working capital, growth capital
Financial instruments used	Unsecured loans, equity, grants (guarantees or security may be required in exceptional circumstances)
Selection criteria	Will support: community and voluntary organisations; individuals or groups starting up a social enterprise; social enterprises looking to grow and develop; social firms which employ a significant number of staff with a disability; organisations whose aims are focused on community impact and use income generated from the provision of goods/services to pursue a social mission; credit unions or other community saving and credit schemes; co-operatives.

London Rebuilding Society

www.londonrebuilding.com

London Rebuilding Society (LRS) is a Community Development Finance Institution structured as an IPS. It specialises in creating innovative forms of finance:

- loans and business support for social enterprises;
- the Mutual Aid Fund (MAF) scheme, in which community organisations are lent money by LRS to form their own microloan fund, particularly successful for migrant communities; and
- home improvement, green retrofit and renewable energy finance for vulnerable low-income homeowners.

The table below refers to the enterprise lending activities (including MAF), and not to the homeowner schemes.

Style of fund	Social investment fund
Capacity of fund	£1.2 million
Sources of capital	Government grants, bank loans, shareholder members
Fund structure	Social enterprise funds
Number in portfolio	123 enterprise loans made over 10 years for a total lent of £3.5 million. Current borrowers: 50
Investee life stage	Seed, growth
Typical deal size	£35,000
Risk profile	High – focus on innovation
Financial instruments used	Secured and unsecured loans
Selection criteria	Will fund social enterprises, not-for-profit sector and privately-owned companies focused on community or environmental benefit.

Private Equity Foundation

www.privateequityfoundation.org

Style of fund	Venture philanthropy
Capacity of fund	Around £20 million
Sources of capital	Donations from individuals and corporates, in particular from the private equity industry
Fund structure	Charitable trust
Number in portfolio	17
Investee life stage	Growth, expansion
Typical deal size	£600,000
Risk profile	Medium risk
Financial instruments used	Grants
Selection criteria	Charities are selected based on: contribution to solving the problem of young people being not in education, employment or training; proven record of effectiveness; strength of leadership; potential for a step change in impact through Private Equity Foundation support.

Social Finance

www.socialfinance.org.uk

Social Finance was established in 2007 to grow the social investment market in the UK by increasing the availability of appropriate sources of finance for the social sector.

Type of organisation	Social investment intermediary
Sources of capital	Trusts and foundations, HNWIs, private banks, corporate social responsibility departments, institutional investors, and the mass affluent
Legal structure	Not for profit company limited by shares
Typical investment vehicle size	£5 million to £250 million
Financial instruments used	Social Impact Bonds, Venture Capital Trusts, funds of funds, equity and debt
Key stakeholders and degree of engagement	Social Finance works with government commissioners, social investors and social purpose organisations. It also works closely with large social sector organisations, impact investors, commissioners, other social investment intermediaries and market builders to develop robust investment propositions that deliver social and financial returns.

The Social Investment Business

www.thesocialinvestmentbusiness.org

The Social Investment Business is a social enterprise owned by the Adventure Capital Fund, a registered charity. It manages the Adventure Capital Fund's portfolio of investments as well as the following government social investment funds: Futurebuilders (Office for Civil Society (OCS)), Communitybuilders (Department for Communities and Local Government and OCS) and the Social Enterprise Investment Fund (Department of Health).

Style of fund	Social enterprise loans, grants and business support
Capacity of fund	Total: £400 million – Futurebuilders England Fund: £215 million; Social Enterprise Investment Fund: £100 million; Communitybuilders (Adventure Capital) Fund: £70 million; and Modernisation Fund: £9.5 million
Sources of capital	UK Government, leveraged commercial and philanthropic finance, business development and support contract work
Fund structure	Fund management service
Number in portfolio	Over 1,200
Investee life stage	All
Typical deal size	£20,000 to £2 million
Risk profile	Medium
Financial instruments used	Secured and unsecured loans, grants
Selection criteria	Criteria vary by fund. All investments must be financially viable, but 'unbankable' – i.e. unable to receive mainstream bank finance. General bank lending criteria require certainty of cash-flow forecasts for loan repayment.

UnLtd

www.unltd.org.uk

Style of fund	Social investment with engagement (multiple funds)
Capacity of fund	£100 million
Sources of capital	Lottery distributor
Fund structure	Permanent endowment
Number in portfolio	1,000s, around 1,250 per year
Investee life stage	Start-up, early stage, replication and investment readiness
Typical deal size	Under £20,000
Risk profile	Start-up, early stage funding
Financial instruments used	Grants
Selection criteria	Individual social entrepreneurs who: demonstrate social value; fulfil a clear need and demand; have clear outputs and goals; and have an entrepreneurial approach.

Annex B
Market failures affecting social investment

1. Imperfect information

- **Information asymmetry between borrowers and lenders.** Where a lender has less information than a borrower about the viability of a business proposition, there is an information asymmetry. A would-be borrower may be rejected for a loan because the lender cannot verify the soundness of its business proposition. This problem is a key source of market failure in the provision of loans to SMEs[1] and there is evidence that social ventures can suffer from similar problems.[2] The problem is exacerbated by the limited track record of lending to social ventures.
- **Lack of information on social return.** There is no accepted standard for measuring social return against performance benchmarks.[3] Some social ventures do attempt measurement, but a variety of methodologies are in use, and it is difficult to compare them. Part of the problem is expense: measuring social return can cost a social venture as much as £10,000, which can be very significant for a smaller organisation.
- **Confusion over terminology.** The lack of a standard lexicon within the social investment marketplace can make it more difficult for supply-side and demand-side organisations to communicate.[4]
- **Imperfect knowledge about existing investment provision.** The landscape of intermediaries can be confusing for social ventures, with no single point of contact for access to social investment. Moreover, the sector as a whole does not systematically disclose information about lending (such as amount, destination of funds and charges) or its actual financial returns (in aggregate and by deal). This can make it difficult to establish exactly where gaps in provision exist.
- **Lack of information about government policy.** Frequent changes of direction in government policy can affect social ventures that sell services to public sector commissioning authorities. The resulting uncertainty over revenues can make it more difficult for such social ventures to raise capital finance.

2. Imperfect competition

- **High transaction costs.** Social ventures can require extensive investment readiness support before they are ready to receive finance, and providing this can be prohibitively expensive for mainstream lenders. The costs associated with collection and underwriting are also high. For the CDFI Aspire it cost £1.40 to lend £1, and for Street UK it cost £2.80 to lend £1.[5] Intermediaries estimate that their average transaction cost is around £5,000 per deal.
- **Lack of brokers/advisers.** Effective competition relies on efficient matching of providers and recipients of funding. In mature investment markets, this matching is facilitated by brokers, who can provide advice to both borrowers and investors. In the social investment market, the lack of brokers hinders the matching of supply and demand[6] and impairs competition.

- **Lack of secondary markets.** The lack of an accepted means of 'selling on' social investments (through a social stock exchange, for example) can deter investors. It can also hinder redeployment of capital to areas where it can most efficiently generate social and financial return.
- **Artificial suppression of demand.** Demand can be skewed towards fundraising and seeking grants – or the availability of 'free' capital – which make the market less efficient than it could be.
- **Variable commissioning practice in local and national government.** Social ventures can find it difficult to bid for public sector contracts due to inaccessible commissioning processes.

3. Externalities

- **Presence of externalities.** Externalities are central to the social investment market. By its nature, social return will generally be external to players in the market – on both the supply and demand sides. An efficient market would develop a means of pricing and thus internalising externalities. This is what the various carbon pricing schemes seek to do – such as the EU Emissions Trading System. However, at least three problems hinder a similar approach for pricing in externalities in the social investment market: (i) lack of an agreed mechanism for measuring and therefore pricing social return; (ii) even where metrics do exist, social benefits may be very long term and therefore especially difficult to measure; (iii) in some cases, financial returns (e.g. savings in provision of services) may accrue to a third party, rather than being captured by the investor. These difficulties affect many market participants, including investors, commissioners of public services and customers.

4. Absence of public goods

- **Failure of the market to provide public goods.** A market failure occurs when a market fails to provide public goods that would have a beneficial effect overall but whose costs cannot be adequately distributed among market participants. In the social investment market, certain key public goods are lacking. For example, there is no industry association for intermediaries and no social investment stock exchange. And open access to innovation, research and development could benefit a range of market participants.

5. Cultural and behavioural barriers

- **Lack of business skills among social ventures.** In many cases, social ventures are not ready to receive investment. Given their focus on social return, some social venture managers have relatively low levels of financial literacy. This can reduce their ability to apply for and make use of external investment, even where it would be in their best interest.
- **Risk aversion among social ventures.** Social ventures can be risk averse and reluctant to shift financing away from grant-funding towards repayable investments, which involves expense and strategy shift. In some cases there is a mistaken perception that acceptance of such investment will create personal liability.
- **Risk aversion among lenders.** Commercial lenders can be myopic about the actual risks and returns associated with social investment. Some social investments are perceived as being much higher risk than they actually are. For example, some commercial lenders have been unwilling to provide loans for funding contracts paid in arrears, even though this is low risk because funding is committed.[7]
- **Lack of public understanding of social enterprise.** A Central Office of Information survey showed that 50% of respondents claimed to know what a social enterprise was, but less than 50% knew it could be profitable. Widespread participation in social investment by the general public will rely on a public understanding of how the social venture sector operates and what it can achieve.

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6 Monitor Institute (2009) *Investing for Social & Environmental Impact*. US: Monitor Institute, available at: www.monitorinstitute.com/impactinvesting/documents/InvestingforSocialandEnvImpact_FullReport_004.pdf

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8 Mitchell L et al (2008) *Financing Civil Society: A practitioner's view of the UK social investment fund*. London: CAF, available at: www.cafonline.org/PDF/Venturesome_FinancingCivilSociety_1806091.pdf

9 'Social venture intermediaries: who they are, what they do, and what they could become,' Young Foundation, February 2011.

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11 Jonathan Jenkins, UnLtd.

12 Reported in New Philanthropy Capital (2011) *Understanding the Demand for and Supply of Social Finance*.

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16 Ibid.

17 Reported in New Philanthropy Capital (2011) *Understanding the Demand for and Supply of Social Finance*.

18 Rowlands C et al (2009) *The Provision of Growth Capital to UK Small and Medium Sized Enterprises*. Norwich: TSO, available at: www.berr.gov.uk/files/file53698.pdf

19 Jonathan Jenkins, UnLtd.

20 Monitor Institute (2009) *Investing for Social & Environmental Impact*. US: Monitor Institute, available at: www.monitorinstitute.com/impactinvesting/documents/InvestingforSocialandEnvImpact_FullReport_004.pdf

21 Mitchell L et al (2008) *Financing Civil Society: A practitioner's view of the UK social investment fund*. London: CAF, available at: www.cafonline.org/PDF/Venturesome_FinancingCivilSociety_1806091.pdf

Chapter 4

1 A community budget pools different strands of Whitehall funding into a single 'account' in order to organise public spending by place, rather than by individual organisation or service.

2 Local Integrated Services engage local people at a neighbourhood level to design services and award contracts to providers who the community feel are best placed to deliver the desired outcomes.

3 Participatory budgeting gives local people a direct say over how to spend a part of a local public budget. People can propose, debate and vote on budgeting priorities. Participatory budgeting has been used to help prioritise spending through a range of local authority services, children's and young people's activities, community policing and tenant management services.

4 www.communities.gov.uk/publications/localgovernment/righttochallengeconsultation

5 The Advancing Assets demonstration programme, funded by the Department for Communities and Local Government, currently provides practical support to local authorities and communities and demonstrates the feasibility of community asset transfer through pilot activity. A wealth of information has been developed as part of the programme.

6 Speech by the Minister for the Cabinet Office, 17 November 2010.

7 Ibid.

8 A Social Impact Bond allows the private sector to raise finance for a Payment by Results contract, whereby the private sector assumes the risk of delivering a public service, and is rewarded by government based on the outcomes it achieves.

9 Allen G (2011) *Early Intervention: The next steps – An independent report to Her Majesty's Government*. London: Cabinet Office, available at: www.dwp.gov.uk/docs/early-intervention-next-steps.pdf

10 An industrial and provident society is an organisation conducting an industry, business or trade, either as a co-operative or for the benefit of the community, and is registered under the Industrial and Provident Societies Act 1965.

11 Heaney V (2010) *Investing in Social Enterprise: The role of tax incentives*. Centre for the Study of Financial Innovation/NESTA, available at: www.nesta.org.uk/library/documents/Investing-in-Social-Enterprise.pdf

12 Ibid.

13 Ibid.

14 Community Development Finance Institutions (CDFIs) are independent financial institutions, serving a specific disadvantaged geographical area or disadvantaged group. CDFIs provide loans (often microfinance) to start-ups, individuals and established enterprises (including social ventures) that are unable to access finance from banks. CDFIs are often linked into local partnerships and supported by local businesses – their main focus is often the creation of enterprises at a local level.

15 cdfa (2010) *Inside Out: The state of Community Development Finance*. London: cdfa, available at: www.cdfa.org.uk/about-cdfis/state-of-cdfis-research/

16 Source: National Council for Voluntary Organisations (2010), *The UK Civil Society Almanac 2010*, Section 3, available at: www.ncvo-vol.org.uk/almanac2010

17 Charity Commission (2010) *Charities and Investment Matters*. Charity Commission, available at: www.charity-commission.gov.uk/library/about_us/consultation_char_invest.pdf

18 The Community Shares and Bonds action research programme is funded by the Cabinet Office and the Department for Communities and Local Government, and is delivered by Co-operatives UK and the Development Trusts Association.

19 Co-regulation is characterised as self-regulation with a legal safeguard. It has the advantage of providing a degree of certainty over the parameters within which organisations may operate due to the legal safeguard, while encouraging innovation through a flexible approach to implementation.

20 BIS (2011) *Bigger, Better Business: Helping small firms start, grow and prosper*. London: BIS, available at: www.bis.gov.uk/assets/biscore/enterprise/docs/b/11-515-bigger-better-business-helping-small-firms

21 www.communities.gov.uk/localgovernment/local/localenterprisepartnerships

22 BIS (2011) *Bigger, Better Business: Helping small firms start, grow and prosper*. London: BIS, available at: www.bis.gov.uk/assets/biscore/enterprise/docs/b/11-515-bigger-better-business-helping-small-firms

23 Ibid.

24 Ibid.

25 Office of the Third Sector (2009) *Social Investment Wholesale Bank: Summary of responses to the consultation*. London: Cabinet Office, available at: www.cabinetoffice.gov.uk/content/cabinet-office-consultations

26 www.businesslink.gov.uk

27 Representative bodies include the Social Enterprise Coalition, the Association of Chief Executives of Voluntary Organisations, the National Council for Voluntary Organisations, Co-operatives UK, the Development Trusts Association, the National Association for Voluntary and Community Action, Social Firms UK and the CIC Association.

28 Speech by the Prime Minister, 2 December 2010, available at: www.number10.gov.uk/news/speeches-and-transcripts/2010/12/business-in-the-community-speech-57805

29 HM Government (2010) *Local Growth: Realising every place's potential*. London: BIS, available at: www.bis.gov.uk/policies/economic-development/local-growth-white-paper

30 http://iris.thegiin.org

31 The SROI Network is a membership organisation of social purpose organisations, investors, commissioners and businesses. See: www.thesroinetwork.org

Chapter 5

1 Office of the Third Sector (2009) *Social Investment Wholesale Bank: Summary of responses to the consultation*. London: Cabinet Office, available at: www.cabinetoffice.gov.uk/content/cabinet-office-consultations

2 A clear conclusion from previous consultations is the need for the *Big Society Bank* to be a wholesaler. The Dormant Bank and Building Society Accounts Act 2008 defines a 'social investment wholesaler' as 'a body that exists to assist or enable other bodies to give financial or other support to third sector organisations' (a third sector organisation being defined as 'an organisation that exists wholly or mainly to provide benefits for society or the environment').

3 To capitalise the *Big Society Bank* using dormant accounts, approval to grant State Aid legally to the *Big Society Bank* must be secured from the European Commission. State Aid rules work to create fair competition for UK companies in Europe. Application of the rules means that competitors in other EU Member States cannot receive unlawful State subsidies which distort competition. In the case of the *Big Society Bank*, State Aid will be considered to be present because resources directed by government (dormant accounts) are used to confer a selective advantage on certain undertakings over others: the *Bank* itself, the social investment intermediaries it invests in, and the front-line organisations they in turn invest in. (An undertaking is any entity, regardless of its legal status, which is engaged in economic activity whether for profit or not.) This has the potential to distort competition and affect trade between Member States. The State Aid approval process could take six months or more.

Annex A

1 Draws on JPA Europe Ltd (2010) *Social Enterprise and The Social Investment Market in the UK: An Initial Overview*, available at: http://evpa.be/wp-content/uploads/2010/10/Social-Enterprise-and-the-Social-Investment-Market-in-the-UK-An-Initial-Overview.pdf

Annex B

1 Rowlands C et al (2009) *The Provision of Growth Capital to UK Small and Medium Sized Enterprises*. Norwich: TSO, available at: www.berr.gov.uk/files/file53698.pdf

2 Mavra L (2011) *Growing Social Enterprise: Research into social replication: A report from the Social Enterprise Coalition.* London: Social Enterprise Coalition, available at: www.socialenterprise.org.uk/data/files/Growing_Social_Enterprise_Report.pdf

3 Arvidson M et al (2011) *The Ambitions and Challenges of SROI*. TSRC. www.tsrc.ac.uk

4 Cohen R et al (2010) *Social Investment Ten Years On*. London: Social Investment Task Force, available at: www.socialinvestmenttaskforce.org/downloads/SITF_10_year_review.pdf

5 GHK Consulting, commissioned by BIS and Cabinet Office (2010) *Evaluation of Community Development Finance Institutions (CDFIs)*. London: BIS, available at: www.bis.gov.uk/assets/biscore/enterprise/docs/10-814-evaluation-community-development-finance-institutions

6 Mitchell L et al (2008) *Financing Civil Society: A practitioner's view of the UK social investment fund.* London: CAF, available at: www.cafonline.org/pdf/Venturesome_FinancingCivilSociety_1806091.pdf

7 Ibid.

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