Department for Work & Pensions

Research Summary

Cabinet Office

GSR GOVERNMENT SOCIAL RESEARCH
Social Science in Government

Growing the social investment market: update on SIFI social investment - Final report

By James Leather (ICF), Angie Jugnauth (ICF), Nick Henry (CBIS, Coventry University), Mélanie Dubuis (ICF) and David Jarvis (CBIS, Coventry University).

ICF International (ICF), working with the Centre for Business in Society at Coventry University, was commissioned by the Department for Work and Pensions and the Cabinet Office to undertake an update study of the size and dynamics of social investment flowing through United Kingdom (UK) social investment finance intermediaries (SIFIs). The study's aim was to examine developments within the UK social investment market in 2012/13 and 2013/14, by comparison to the data for SIFIs for 2011/12, as published in ICF GHK (2013)[1]. A further aim of this update study was to consider new developments in, and channels of, 'non-SIFI' social investment.

Methodology and study parameters

The research activities undertaken during the study consisted of:

- a web survey of all SIFIs that were presumed to be active in the social investment market, in order to collect data on their social investment activities in 2012/13, 2013/14 and 2014/15 (predicted investment levels[2]); and,
- a review of social investment reports, websites, news literature, etc. to identify new investors, investment mechanisms and developments in the social investment sector. Where necessary, these reviews were followed-up by telephone discussions for clarification.

The key definitions that were used to define the parameters of the study were as follows:

SIFIs and social investment

For the purposes of this study, a SIFI has been defined as an organisation that provides, facilitates or structures social investments for social ventures[3]. This repeats the definition previously used in the 2013 ICF GHK study enabling comparisons to be made across years to measure change in SIFI market size.

[1] ICF GHK (2013) Growing the Social Investment Market: The Landscape and Economic Impact. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/210408/Social-Investment-Report1.pdf

[2] Fieldwork with SIFIs took place in January and February 2015, meaning that figures through to the end of March 2015 were estimated (albeit at a point in time when SIFIs would be expected to be reasonably certain of their investment through to the end of the financial year).The terms "forecast" and "predicted" are used interchangeably to describe 2014/15 data.

[3] Adapted from http://www.bigsocietycapital.com/glossary

Other types of social investor exist including, for example, individuals or institutions investing directly in social ventures. For this study, the term 'non-SIFI social investment' has been used initially to distinguish any social investors that invest directly in social ventures.

Social investment has been defined as investment (the provision, facilitation or structuring of repayable finance) that intentionally targets specific social objectives along with a financial return. What constitutes a social objective was not specified for this study, and can include a range of improved outcomes for society, such as health improvements, employability, the provision of community goods, and the impact of reduced carbon emissions. In this study, social investment may include investment in social enterprises, mutuals, charities, community interest companies, and cooperatives.

Social investment: expanding horizons

In its ambition to create a 'thriving social investment market', Her Majesty's Government is seeking increased supply and diversity of investors and lenders – both individual and institutional. Very recent experience of UK social investment market developments implies that such diversity will be accompanied by new investors, new investment products, and new channels as the 'personality types' of investor groups are increasingly matched to a growing investment demand of greater clarity.

Such dynamism is evident in the findings of this study – through the growth of a new breed of large SIFIs, set next to a number of innovating and specialised small SIFIs, and all set alongside the longer-standing social banks.

Such dynamism is, however, both greater than that of the market activity of SIFIs alone and to be set within a growing international environment seeking to converge around agreed definitions, measurements and standards for social investment. Any future update assessment of the size of the UK social investment market will need to be mindful of such expanding horizons in seeking to both hold to the value of historical trend analysis whilst encompassing also the full array and diversity of market development.

Key findings

Social investment by SIFIs

The volume of social investment has grown steadily. The number of investments made by SIFIs increased from 765 investments in 2011/12 to 1,204 investments in 2013/14 (and a predicted 2,583 of investments in 2014/15). The average value of investments fell from £264,000 in 2011/12 to £140,000 in 2013/14.

The value of UK social investments made by SIFIs in 2013/14 stood at £168.4 million (down from £202.2 million in 2011/12). SIFIs forecast that this would increase to £212 million of social investment in 2014/15. This pattern is largely explained by slower social investment activity by social banks. Much of the drop in the total value of SIFI social investment between 2011/12 and 2013/14 can be explained by a sharp decrease in the value of investment by social banks; over these two years the value of investment by this group dropped from £165.8 million in 2011/12 to £110.4 million in 2013/14. Elsewhere[4] this decrease has been attributed to the temporary effects of restructuring within social banks.

Slower investment activity by social banks was partially compensated for by growth in social investment by 'large SIFIs'[5], including that of new entrants. Investment by large SIFIs grew from £30.3 million in 2011/12 to £55 million in 2013/14. In 2014/15, large SIFIs were predicted to have carried out £119.1 million

---

4 CDFA (2013: 31). 'Inside Community Finance 2013.' Available http://www.miningtheseem.org.uk/wp-content/uploads/2014/03/ICF-2013.pdf

5 Defined as SIFIs that make at least £1 million of social investments in a year.

of social investment, equal to a market share of 56 per cent (up from 15 per cent in 2011/12). Part of this expansion was the result of six new market entrants since the 2013 ICF GHK study, that have grown quickly to be classed as large SIFIs. By 2014/15, new entrants predict they will have added £51.7 million to the social investment market, accounting for 24 per cent of the total. Another growth area has been four SIFIs classed as small in 2011/12, which have since grown rapidly to become classed as large SIFIs. These SIFIs predict that they made £34.8 million of social investment in 2014/15 (equal to 16 per cent of the market).

Debt finance continues to be the key investment vehicle, with growth in the share of unsecured loans. Debt finance (loans) makes up the majority (by value) of the social investment by SIFIs (91 per cent of the market in 2013/14). However, the share has fallen slightly since 2011/12 (when debt finance made up 95 per cent of the total social investment market by value). It remains the case that most of this debt finance is in the form of secured loans, but it is notable that unsecured lending has grown in importance. In 2011/12, unsecured loans made up just 5 per cent of the total social investment market; in 2013/14 the proportion had increased to 26 per cent of the market.

Much of the remainder of the SIFI social investment market is made up of equity, quasi-equity and social impact bonds. Collectively, in 2013/14 the value of investment via these three investment products amounted to £7 million (equal to a market share of 4 per cent), similar to its 2011/12 value of £7.2 million. In 2014/15, however, SIFIs forecast that equity, quasi-equity and social impact bond investments would amount to £25.3 million, a collective market share of 12 per cent (up from 4 per cent in 2011/12).

Average expected returns by investment type are similar across products, standing at between 6 per cent (the average interest rate on a secured loan) and 8–9 per cent (the average expected internal rate of return (IRR) for equity, quasi-equity and social impact bonds). Average interest rates on debt finance decreased between 2013 and 2015, but average IRRs on equity, quasi-equity and social impact bonds increased.

At least 70 per cent of SIFIs were prepared to serve each devolved administration or English region. The devolved administrations and English regions are all served by at least 70 per cent of SIFIs, reflecting the fact that the majority of SIFIs serve national markets (indeed the proportion operating UK-wide increased to 72 per cent in 2015 from 66 per cent in 2013).

Similarly, SIFIs were prepared to serve a wide range of sectors of activity, spanning community facilities, healthcare, social care, childcare, education, employment and skills, and the environment/green economy. Most sectors are served by the majority of SIFIs.

SIFIs identified a range of opportunities for market growth, including: opportunities provided by emerging financial product types; an increased supply of investment capital (e.g. through SITR); and growing demand amongst some social ventures for investment, including some improvements in investment readiness.

Barriers to growth identified by SIFIs included: a shortage of quality investment opportunities; the administrative burden from complying with financial regulation; a continued lack of demand for investment amongst some social ventures; and, for some SIFIs, a lack of investment readiness amongst some social ventures.

Measuring the social investment market going forward

Market dynamism within the social investment sector is reflected in a broadening understanding of what constitutes social investment. A ‘narrow’, SIFI-based definition of social investment – which was replicated in this study in order to generate data that could be compared with previous studies – does not take account of recent developments in the types and motivations of social investors, new forms of product, and new investment channels.

New types of investor have emerged (though it is notable that many of these new investors have elected to channel their investments through existing SIFIs), including the expanding social investment activities of charitable foundations. Many of these new investors reflect what collectively have been termed 'responsible investment' approaches, a term used to describe a growing diversity of investor motivations and expectations of return (both in and beyond social investment).

New forms of social investment product have emerged, such as growth in the community shares sector. This illustrates the importance of definitional issues within the social investment sector since, whilst social motivation of investors in community shares is paramount, the prospect of a financial return is important only to a minority.

New investment channels have emerged, with some of the greatest dynamism evident in the move to 'platforms' and associated crowd-based funding activity, including as social investment has moved into the retail investment space for individuals.

The full report of these research findings is published by the Department for Work and Pensions (ISBN 978 1 911003 35 9. Research Report 923. July 2016).

You can download the full report free from: https://www.gov.uk/government/organisations/department-for-work-pensions/about/research#research-publications

Other report summaries in the research series are also available from the website above.

If you would like to know more about DWP research, please email: Socialresearch@dwp.gsi.gov.uk