

3 August 2016

Mission-led Business Review Secretariat
c/o Alexandra Meagher
Cabinet Office
1 Horse Guards Road

Dear Ms Meagher,

Cabinet Office Mission-led Business Review

Thank you for the opportunity to feed-in to the Cabinet Office's Mission-led Business Review. We appreciate the chance to put forward our views and understand you have already received feedback from some of our members. While we do not answer individual questions we do make several points which we feel should be considered as part of the review. As you may know, the financial adviser chapter of UKSIF, the Ethical Investment Association (EIA), take a keen interest in your work on social investment and we would be happy to facilitate any discussions with the EIA on their views in regard to this work.

Definitions

We welcome the Minister's statement that 'every business could, if it wished, be a mission-led business'. While it is certainly the case that throughout the UK there are many entrepreneurs and start-up businesses which are geared towards both making a profit and making a difference, the core principle of having a positive social impact should not and cannot be exclusive to small or new businesses. Many UKSIF members invest in businesses – large and small – which aim to tackle many of the social issues faced throughout the country and we note that the Government has been extremely helpful in supporting the development of the UK's social investment market. It is generally the case, however, that members are better positioned to invest in large companies, or those which are scalable. This should be a key consideration as you look to implement any changes.

We would be more cautious about introducing any set of criteria or narrow definition for what constitutes a mission-led business. This is unlikely to be helpful to those businesses which seek to have a positive impact and could provide further regulatory barriers for social investors.¹ It would be unhelpful to introduce any definition which could stifle growth, either among those businesses which identify as mission-led or those businesses which are for-profit but have a focus on having a positive impact beyond that of their peers. Indeed one of the biggest challenges for the impact market has been scalability: a narrow definition which excludes for-profit businesses which are already having a positive impact is unlikely to overcome this challenge.

Transparency

Quantitative data is vital to enable investors to assess businesses' ability to create value over time. It is therefore important to raise standards for all companies, mission-led or otherwise. Over the past

¹ Our response to the FCA consultation on regulatory barriers to social investment is available at <http://uksif.org/wp-content/uploads/2016/03/UKSIF-response-to-FCA-regulatory-barriers-to-social-investment.pdf>

few years we have seen an increased focus on transparency and corporate reporting. These developments have been welcome and have represented an increased recognition of the importance of sustainability factors in business performance.

In our submission to the BIS consultation on non-financial reporting we called for the government to ensure that ‘non-financial information’² was included in the strategic report because it provides detailed information to stakeholders on a business’ ability to create value over time. We would go further than this and call for fully integrated reporting on sustainability factors. Far from being a burden on business, integrating financially material sustainability concerns into business models would ease year-end reporting. It would also enable investors to fully assess the universe of impactful investments available to them, further driving the benefits to society and the environment. A recent Eurosif and ACCA study showed that 96% of investors agreed or strongly agreed that quantitative KPIs are essential to assess corporate sustainability performance, while 76% agreed or strongly agreed that qualitative policy statements are essential.³

Rationale for becoming a mission-led business

Every year UKSIF commissions polling for Good Money Week in relation to savers’ views on their investments. This year it revealed that 54% of people with savings want to make a “positive difference” as well as a return. Standard Life commissioned polling revealed a positive correlation between positive values and youth with 58% of millennials wanting to invest in companies that achieve positive social outcomes, and 51% wanting to invest in ways that minimise environmental damage. More millennials have investments or savings than at any other time in recent memory, mainly thanks to automatic enrolment. There is a clear commercial opportunity to becoming a mission-led business. Businesses and pension funds will therefore need to start to consider these views and their own impact on society and the environment in order to stay competitive.

Not all businesses which have a positive impact on society or the environment identify as being mission-led, yet there are clear benefits to those which consider their impact. A 2013 EY study showed there are many benefits to companies from increased consideration of sustainability factors in the way they conduct their business. These include:

- Improve access to capital;
- Increased efficiency and waste reduction: a 2012 survey of sustainability reporters showed 88% indicated that reporting helped make their organisations’ decision making processes more efficient;
- Meeting the expectations of employees: The EY study showed 30% of employees felt increased loyalty to their employer as a result of reporting. A separate 2011 EY study showed employees were a vital part of the sustainability report, with 18% citing employees as the report’s primary audience. We can infer from this that the sustainability report also offers a company a competitive advantage in hiring talent as well as workforce retention;
- Better reputation: The study showed that 50% of respondents that issued sustainability reports stated that those reports helped improve the company’s reputation.

² Since this information is financially material this term is a misnomer and therefore unhelpful.

³ Eurosif and ACCA, *What do investors expect from non-financial reporting?*, available at <http://www.accaglobal.com/content/dam/acca/global/PDF-technical/sustainability-reporting/tech-tp-wdir.pdf>

Companies which consider their impact on society and the environment gain a competitive advantage over their peers. Any government initiative to encourage or require companies to consider this impact would therefore be of commercial benefit to those companies and would also help prevent the “mission drift” referred to in the consultation document.

Barriers to becoming a mission-led business

We see two key barriers to becoming a mission-led business. The first surrounds misconception on investors’ fiduciary duties, while the second is due to regulatory barriers in social investment.

UKSIF has worked for many years to clarify that investors’ fiduciary duties do not require them solely to maximise financial returns. The Law Commission’s 2014 report into fiduciary duties was helpful in this regard. It found that pension fund trustees *should* take into account financially material factors.⁴ Clearly increased reporting of both quantitative and qualitative data would be very helpful to investors in fulfilling their fiduciary duties. The EU’s Non-Financial Reporting Directive and the FSB’s Taskforce on Climate Related Financial Disclosures will be helpful in supporting this. The government should consider ways in which they can support implementation. It also found that, subject to two tests, non-financial factors could be taken into account, something which perhaps has not been communicated as widely as it could have been, and which could provide a clear boost to the mission-led business market.⁵

Despite this clarification many investors are either not aware of this or continue to use the “fiduciary duties are a barrier” excuse. Despite this some bodies, specifically The Pensions Regulator and DCLG are doing a good job of highlighting that ESG and non-financial considerations are not prohibited by fiduciary duties. The Government can still do more to educate investors however, and should initially focus on ways in which the FCA and the Charity Commission can do more to dispel this myth in codes of practice and guidance. An industry-backed, simple, agreed understanding of fiduciary duty that could be replicated for investors of all types would ultimately be hugely significant in promoting responsible investment of all types.

There are also regulatory barriers to the growth of the social investment market.⁶ In particular the government should look to address the obstacles for retail investors wishing to invest in mission-led businesses. The current regulatory regime may be unhelpful in this regard and it has been shown to inhibit the ability of some mission-led businesses to raise money from the general public. This is an important source of finance for these types of businesses and motivations for attracting investment here are diverse. Motivations include diversifying the investor base, raising awareness for the work of the social enterprise or charity and forging deeper connections with the communities in which they operate.⁷ A recent report has also shown that while over 50% of investors said they would be interested in investing in businesses which have a positive impact, only 9% had actively engaged.

⁴ Available at http://www.lawcom.gov.uk/wp-content/uploads/2015/03/lc350_fiduciary_duties.pdf

⁵ That scheme members agree and that there is no risk of significant financial detriment to the fund.

⁶ UKSIF’s response to the FCA’s consultation is available here <http://uksif.org/wp-content/uploads/2016/03/UKSIF-response-to-FCA-regulatory-barriers-to-social-investment.pdf>

⁷ Big Society Capital, *Social Investment Insights Series*, available here: http://www.bigsocietycapital.com/sites/default/files/attachments/Social%20Investment%20Insights%20-%20Retail%20social%20investment%20across%20the%20world_2.pdf

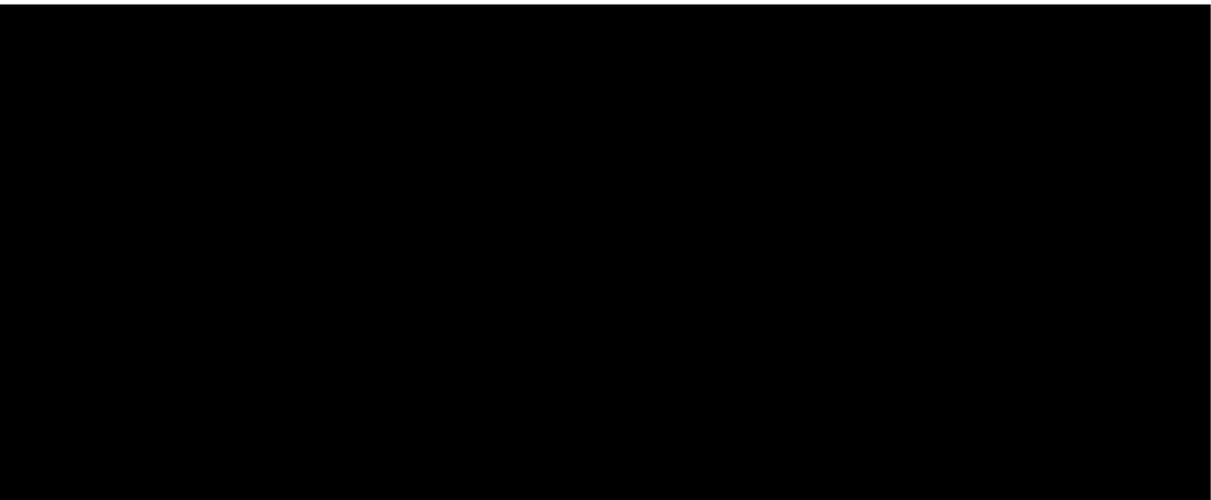
This is a clear gap that needs to be bridged and the Cabinet Office should work closely with the FCA on ways in which it can achieve this.

Our discussions with the Ethical Investment Association⁸ have also revealed other factors which may obstruct investment in mission-led businesses. These include:

- The fact that this is a still-nascent market has been problematic. These types of investments may be considered more risky than traditional investment due to a lack of any track record of successful delivery. We have heard anecdotal evidence that this may be off-putting to financial advisers other than specialists.
- Objective assessment of factors such as diversification, past returns and illiquidity may tend to lead to advice focusing on traditional investment types since the newer can't demonstrate data in these areas due to their current small size and short-track record. If the aim is to accelerate growth some flexibility will need to be introduced into the system.
- The Financial Ombudsman Service is not subject to FCA rules and FOS liability is unlimited. A lack of a long-stop means that cases can be brought even by executors. The impact will be compounded on investments which some already consider to be riskier.

The government should be sure any policy actions in response to this consultation do not stifle innovation or result in too prescriptive a definition of what a mission-led business is. That in itself could become a significant barrier to growth of the market or new businesses seeking to have a positive social or environmental impact.

I trust the above information is clear, but if you require clarification on any of the points raised please do not hesitate to contact me.



⁸ <http://ethicalinvestment.org.uk/>