

BVCA response to the Cabinet Office's call for evidence on Mission-led businesses (deadline 8 July)

- **Introduction: mission-led business in the broader context of impact investing**

We welcome this call for evidence which acknowledges the rise of profit-with-purpose businesses. We indeed believe that making a social impact is not limited only to organisations within the regulated social sector and that the rise of profit-with-purpose businesses is likely to be a key driver of growth for the impact investment sector. We believe that there is a spectrum of impact capital, ranging from sustainable to impact-only investments, and that these strands are not mutually exclusive. We agree with the assertion that sustainability of society will not depend on preventing social businesses from going commercial but on making businesses of any type and form meet societal challenges. We believe that embedding impact into their activities is applicable to every business and that ultimately this move should be encouraged for all businesses. We therefore recommend keeping any definition of mission-led businesses as flexible as possible in order to capture as many businesses as possible into its scope.

The definition of mission-led businesses, as suggested by the panel led by Nigel Wilson, is the following: “New businesses are emerging that are making a commitment to achieving a social as well as financial impact. These businesses – which some call “mission-led” businesses – are profit-driven and profit-distributing, but also make a powerful commitment to social impact.” There are three characteristics that really matter: the intent and duties to deliver an impact, and reporting on impact.

The mission-led businesses provide an opportunity to help drive social impact at scale. As they are able to distribute profits whilst committing to achieving an impact, those profit-with-purpose businesses are likely to attract more source of capital, notably equity investment, and to draw mainstream investors in the social space. The BVCA believes that profit-with-purpose businesses constitutes an avenue to bring social impact investing into the mainstream, providing their structures are kept flexible and do not impede investment.

The private equity and venture capital industry is committed to playing its part to contribute to the growth of the social investment sector; impact as well as commercial private equity and venture capital investors are increasingly attracted to impact. We believe that equity investments are particularly well suited to the long-term nature of social organisations and private equity and venture capital investors have the experience, the capital and the skills required to scale up a social business.

- **Number and profile of mission-led businesses:**

Question 1: What do you know about the number and profile of mission-led businesses operating in the UK? Please share evidence.

A previous attempt to estimate the scale of the social business opportunity has been done by Big Society Capital and Bridges IMPACT+ in September 2014 in the report [‘The Social Business Frontier’](#). It established that outside the regulated social sector, there were at least 250,000 social businesses in the UK deliberately delivering social impact, employing 2.136 million people and amounting to £163 billion in turnover.

But there could be many more mission-led businesses than the above estimates, considering that there is at least 1.5 times the number of private companies currently identifying as social enterprises than as registered charities¹, and that one in five entrepreneurs want to go social².

According to a report commissioned by Big Society Capital, about 8% (i.e. approximately 100,000 businesses) of the UK's small and medium sized enterprise employers are impact focused, albeit they distribute profits³.

One of the features of mission-led businesses is to appropriately protect their social mission without rigidity, so they can be identified as 'profit-with-purpose' business, in the absence of a specific legal form as most mission-led businesses are set up as a company limited by share. A mission lock allows commercial and social investors to identify impact-driven investment propositions. 'The size and composition of social investment in the UK', a recent report by Big Society Capital (March 2016), provides the first comprehensive estimate of the market. It shows that 30% of the UK social investment segment in 2015 was channelled to non asset-locked organisations, amounting to £462 million of investment. A great share of this can be attributed to the level of investment received by mission-led businesses.

Question 2: What do you know about the impact of being a mission-led business on business performance and social impact? Please share evidence.

There is a strong business as well as social case for being a mission-led business. The impact achieved is at the core of the business model and identifying where that impact lies is key to measure the success of mission-led business. The impact achieved drives commercial value, as growth opportunities from underlying societal needs are leveraged on.

The private equity and venture capital industry is uniquely qualified to identify opportunities and drive commercial value from impact as well as scale-up those impact-driven businesses responsibly. Social businesses also often spur innovation and creativity in a greater extent than traditional businesses. The performance and value generated by a mission-led business are also improved by other drivers such as an engaged workforce which boosts its productivity as well as a loyal customer base which ensures its profitability.

Bringing entrepreneurial and innovative market solutions to some environmental and social issues is very impactful and is complementary to the work led by philanthropies and the Government in this area. Some issues warrant substantial investment and more scalable solutions than grants and donations. By locking in their social mission, those businesses demonstrate that the commitment to a defined outcome and beneficiary type is protected whilst still generating financial returns, meaning that profits can go hand in hand with purpose.

Question 3: In your view, what are the ways that quantitative data on mission-led businesses could be better captured over time?

There is scope for Companies House to capture information on mission-led businesses whenever the governance of this entity reflects the mission-lock. "In the UK the constitution of a company (limited by guarantee or by shares) is required to be filed with Companies House and therefore becomes a matter of

¹ 'The Social Business Frontier', Big Society Capital and Bridges IMPACT+, September 2014, http://bridgesventures.com/wp-content/uploads/2014/11/Social-business-frontier_final3.pdf

² According to the Report of the Social Impact Investment Taskforce Mission Alignment working group - <http://www.socialimpactinvestment.org/reports/Mission%20Alignment%20WG%20paper%20FINAL.pdf>

³ 'Going for Gold', by Hogan Lovells, for Big Society Capital, 2015

public record. As the mission statement itself form part of the articles of association of such an entity, both impact and profit-driven investors alike can easily identify a profit with purpose business”⁴.

Above all, in order to encourage a broader discussion about the role of business in the 21st century, transparency and disclosure initiatives by private companies are necessary and could be drawn from the Private Equity Reporting Group⁵ which recently added in its Guidelines the requirement to disclose information relating to the environmental, social and governance activity of the company.

- **Drivers of growth for mission-led businesses:**

Question 4: Why would a business set-up as or become a mission-led business? Please share evidence.

A business would set up as mission-led first and foremost because this model allows for the vision and values that are underpinned by a business to flourish. The mission lock helps the business to stay true to its social mission.

This decision is further driven by similar calls on a supply and demand level, with the primary motivation for mainstream investors to allocate capital to impact investments being their commitment as responsible investor⁶ and the Millennials generation believing that the first purpose of business is to improve society⁷. Investors and customers alike are keen to align their investments/purchases with their values.

One of the main reasons for social organisations to not take a regulated social sector form, is the desire to maintain flexibility at an early stage of the business, as well as to avoid the potential negative effect from asset locks on capital raising.

Question 5: How do you see mission-led businesses developing over the next decade? Please share evidence.

The demand for more sustainable, transparent, inclusive businesses is set to continue over time.

Alongside the rise of profit-with-purpose businesses, the desire for early evidence of outcomes performance is likely to increase in order to allow benchmarking.

- **Mission-led business – case studies:**

TOMS, backed by commercial private equity firm Bain Capital, is a provider of branded footwear, eyewear, and shoes through wholesale, retail, and online channels in the US and internationally. The company is known for its innovative One for One™ giving model, where for every product purchased they help a person in need. The social mission in this case is embedded in the ‘Buy one, donate one’ business model. This philanthropic commitment resonates very strongly with customers, and the company is very profitable with a reported revenue in 2015 of US\$392 million.

The Gym is a leading operator of low-cost gyms, backed by commercial investor Phoenix Capital Partners and specialist impact fund Bridges Ventures. Two-thirds of The Gym sites are located in underserved markets. Since opening, around one-third of users are first-time gym users, a rate which has remained

⁴ ‘Going for gold – how golden shares can help lock in mission for social enterprises’, Big Society Capital - <http://www.bigsocietycapital.com/sites/default/files/attachments/Golden%20Share%20Report.pdf>

⁵ http://privateequityreportinggroup.co.uk/wp-content/uploads/2015/11/gmg_guidelines-jul14_final.pdf

⁶ 2016 GIIN Annual Impact Investor Survey

⁷ Deloitte Millennial Survey 2016

constant even as the business has rapidly grown across the UK. The commitment to having a significant societal outcome is embedded into the company's core product. The locks used here are the investment agreement/covenant and the Board/shareholders voting rights. The Gym members became the social customers with power to enforce behaviour and allowing that there is no mission drift. The company is very profitable, with £60 million of revenue generated in 2015. Created in 2008 with £1 million of investment from Bridges Ventures, The Gym was an immediate success and grew rapidly to account now to over 400,000 members and more than 70 sites in the UK. The business was valued at £92 million in 2013 and provided market returns for its investors, with a 0% IRR and 3.7x multiple.

Café Direct Plc is the UK's largest 100% Fairtrade hot drinks company, selling wholesale coffee, tea, cocoa and spices that are sourced directly from growers. Originally founded by Oxfam in 1991, it became a PLC in 2004 by raising £5m from over 4,500 mostly individual shareholders, diluting the original owners to 40%. Café Direct Plc then developed its own Gold Standard, safeguarded by the grower-owned cooperative the Guardian Share Company Ltd which holds two out of eight seats on Café Direct Board. The Gold Standard is built around three key principles: grower focused in all Café Direct does; integrated environmental action; inspirational and accountable business. The company reinvests at least one third of its profits to grower businesses and communities; to date it has actually reinvested over 50% of its profits. Since 2004, total payments to farmers in the developing world amount to more than £15.5 million. Café Direct generated £11.8 m of revenue in 2014.

- **Routes to becoming a mission-led business:**

Question 6: What are the practical steps that a business can take to make a commitment to deliver on its intention to have a positive social impact?

Impact investors seek to protect impact in the businesses they are invested in as impact is a key driver of growth. Investment managers, including impact private equity funds, act as an enforcer of the social mission. The social impact of the business is indeed a key consideration at each phase of the investment cycle by a fund, beyond the sole ownership period: from due-diligence process at the pre-investment stage, to the exit phase where the mission lock can be leveraged further to build recognition and confidence in the social commitment of the business. During the ownership phase, investment managers continuously assess the impact achieved by the business and social impact is a key agenda item of any Board meeting with investors.

Embedding the social mission into the governance structure, notably by appointing a social impact director or codifying it in the articles of the organization, is particularly suitable when a mature traditional business decides to become more social. Overall, we believe that the best route to locking in impact is through good governance.

The social mission can also be embedded into the business model of a company, notably a 'buy one, donate one' business, linking sale of its core product to delivery of impact. In this case, the customers are the best enforcer of the mission lock, as they are driven by considerations of social impact. Putting a price on the impact achieved by a business is therefore essential and can be helped by improved transparency and reporting initiatives.

When a mission-led business is invested in by a non-social investor, using an external certification such as B Corps to protect the social mission, can prove very useful. Certified B Corporations (also known as 'B Corps') are companies that have been certified by the non-profit organisation B Lab to have met high quality and independent standards of social and environmental performance, transparency and accountability. The B Corps label then acts as a proxy for good governance and management.

The use of a golden shareholder - whereby a charity or beneficiary whom social impact is the primary focus, is able to exercise a negative right (a veto) over key social objectives - constitutes another way for a business to protect its social mission. In this case, the right to profit is separated from the right to control the company's primary purpose, so there is no potential conflict arising from the perceived or otherwise misalignment of profit and social impact. As outlined by Big Society Capital⁸, issuing a golden share can be particularly attractive to start-ups wishing to protect their social mission, to social scale ups taking investment from private investors as their control may be diluted from the original owners, and to mature businesses wishing to leverage on their long-term competitive advantage to deliver social impact and safeguard their legacy.

Question 7: Do you think these steps could be better communicated to entrepreneurs and businesses? If so, how?

Raising awareness and improving understanding of the considerations around the impactful role of business is necessary, throughout the whole value chain of investment – from investors to investment managers to investees and their stakeholders.

Information about the B Corp certification, available to businesses around the world including the UK and recently supported in the UK specifically with the launch of B Lab UK in September 2015, should be disseminated at a larger scale and signposted by the key players in the social investment market in the UK.

Awareness and understanding of the Golden Shareholder system should also be improved. The golden share draws on current structures and its use is sanctioned by the common law in the UK and is not unlawful under the UK Companies Act 2006. However it appears to be only lightly used in the UK for social purposes and greater coordination may improve this.

Question 8: The loss of focus on social and environmental aims has been identified as a potential problem for mission-led businesses (“mission drift”). When do you think this is most likely to happen? What could be done to prevent this?

Social businesses can be at risk of losing focus on social and environmental aims in some situations and can protect against such mission drift through a mission lock. However, even mission locks and golden share structures do not always prevent a mission drift from happening. The best guarantee to ensuring continuity in the social mission is a thoughtful and well-governed approach to environmental and social issues.

The risk of a mission drift - or the migration to an easier outcome or easier to reach beneficiary - can happen in difficult economic times for a business, when financial considerations risk being prioritized over the impact of a business. In such case of potential trade-offs between achieving their social mission and making a financial return, having an impact investor with aligned expectations in terms of both financial and social returns, is very valuable to those businesses that are profit-driven and make a powerful commitment to social impact at the same time.

The necessity for a social business to guard itself against a mission drift is also topical in case of ownership change, particularly where the original founder team is exiting the business or relinquishing significant control to incoming investors. Where the commitment to making a social impact was codified by an investor-led mechanism, in case of acquisition by a non-social organization, a more appropriate and irrevocable mission lock such as golden shares can prove necessary, so that the stakeholders of a mission-

⁸ 'Going for gold', Big Society Capital

led business are convinced that the business will remain true to its social mission even beyond the change of ownership.

Question 9: Have you identified barriers to new entrepreneurs or established businesses who want to easily convert their intent to make social impact into a long-term or binding commitment?

If yes, please provide details of these barriers, in particular identifying those that may be caused by regulation.

Social entrepreneurs who want to lock in their impact commitment may be held back by the potential consequences a mission lock that is set too tightly would have on raising capital from investors or on commercial performance: “Make that lock too tight and the ability of the business to grow in the longer term will be hindered. Locking in a social mission can be an effective legal means of ensuring that a social purpose is protected from profit-seekers. However, a mission lock can just as easily shackle a business and prevent it from achieving inward investment and growth, and thus equally limit the ability of the enterprise to adequately achieve that very same mission.”⁹ Any type of mission lock chosen by a profit-with-purpose business should not restrict the day to day management but protect only what is necessary to ensure the continued centrality of the social mission to an enterprise.

Question 10: In your view, what are the barriers to a large corporate (including a public company) to becoming a mission-led business or owning a mission-led business within its group structure?

Shareholders in a large corporate would need to have aligned interests and expectations in terms of financial and social returns. Short-term financial obligations of existing shareholders can act as a barrier. It is therefore important for mainstream businesses that consider becoming mission-led businesses to highlight to their investors the long-term and stable value of investments in an impact-driven organisation. Ensuring that the social commitment is genuine is of course critical.

Question 11: Do you think mission-led businesses have or should have a different culture/values system to traditional (i.e. non mission-led) business? If yes, please provide best practice examples of this.

At present, mission-led business differs from a traditional business in that it does hold social impact in its mission statement upon which it is founded and also reports on the social impact achieved along its commercial value. A traditional business can of course underpin a responsible operating model but is not as firmly accountable for the social impact delivered. We hope that such distinction will become obsolete and that all businesses will be taking their impact into account.

- **Understanding how mission-led businesses can engage with potential customers, employees and investors**

Question 12: What challenges do mission-led businesses face when engaging with potential customers, employees and investors about their social impact?

In order for mission-led businesses to convince a broad range of stakeholders – employees, customers, communities, etc – beyond the sole shareholders that their social commitment is more than just branding or positioning, but instead is at the core of the business vision and governance, we believe that the social and environmental impact achieved by mission-led business should be communicated to those stakeholders in a more engaging way. The theory of change of such businesses should form a key part of their engagement strategy with prospective customers and employees alike. Innovative campaigns such as

⁹ ‘Going for gold’, Big Society Capital

the Buy Social Corporate Challenge led by Social Enterprise UK whereby a group of high profile businesses aim to spend £1 billion with social enterprises by 2020, are worthwhile to increase awareness of the impact of procurement and can help drive real behavioural change.

Using standardized models to assess and measure impact is also important to allow market comparisons and assess what a good outcome is. The Impact Report that is made public following the B Corps certification process can be valuable to demonstrate the value of buying from/working with/investing in mission-led business.

Question 13: What do you think is the role of certifications systems (e.g. B Corps) or of frameworks (e.g. Blueprint for Better Business) in helping mission-led businesses engage with external stakeholders?

One way for mission-led businesses to advertise their ‘profit with purpose’ credentials is by certifying as a B Corp: “B Corp is a ‘profit with purpose’ business with a self-imposed mission-lock (via the amended articles) plus a kind of performance lock (the strength of which will be assessed by the B Lab test)”¹⁰. The B Corps certification process can constitute a valuable label for a social business when engaging with external stakeholders.

- **Mission-led businesses: Reporting on social impact**

Question 14: What are best practice examples of social impact measurement and how are they being applied by mission-led businesses?

There are many different types of impact validation techniques that exist to measure the impact delivered. The Nesta Standards of Evidence constitute a useful approach used to measure the impact of a range of social investments. The IRIS initiative led by the Global Impact Investing Network since 2009 aims to support transparency, credibility, and accountability in impact measurement practices across the impact investment industry. The IRIS metrics are designed to measure the social, environmental and financial performance of an investment, but are more US focused.

- **Support for mission-led businesses**

Question 15: Have you identified specific barriers to the growth of mission-led businesses? If yes, please provide details of these barriers, in particular identifying those that may be caused by regulation.

The ‘company limited by shares’ legal form is already quite flexible in that it permits a company to add a social purpose and impose bespoke social duties on directors’ decision-making.

However, the clarification of fiduciary duties for investors is required, as too often it acts as a barrier to investors integrating impact into their investment decisions. As recommended by the UNPRI, “policymakers and regulators should clarify that fiduciary duties require investors to take account of ESG issues in their investment processes, in their active ownership activities and in their public policy engagement”¹¹. Investment trustees should be more clearly required to demonstrate that they act in accordance with the wider wishes of their beneficiaries – i.e factoring in social and environmental considerations in addition to pure financial considerations. Pricing externalities by investors would help shift business behaviour towards more long-term outcome and social and environmental impact.

¹⁰ ‘To B or not to B, An Investor’s Guide to B Corps’, Bridges Ventures, September 2015, <http://bridgesventures.com/wp-content/uploads/2015/11/To-B-or-Not-To-B-6-print.pdf>

¹¹ ‘Fiduciary duty in the 21st century’, Principles for Responsible Investment Association, September 2015

Further to this, given that pension funds are a natural route to access individual investors at scale, the next step as advocated by the Global Impact Investment Steering Group, should be to encourage pension fund managers that offer defined contribution investment funds to include impact investment options as part of their offering.

Question 16: What do existing mission-led businesses need in terms of support and what do you think could be done to incentivise the creation of more mission-led businesses over the next decade? Who is best placed to do this?

Raising awareness of and celebrating the commercial success and impact performance of mission-led businesses would certainly help in further establishing this type of business and its role on the economy and broader society.

There is not an asymmetry between the supply and demand of capital for profit-with-purpose business, as opposed to regulated social sector organisations; therefore we don't believe that mission-led businesses need to be subsidized.